YOUR TELEVISION IS RINGING: A SPECIAL REPORT ON THE FUTURE OF TELECOMS

The Economist

OCTOBER 14TH–20TH 2006 www.economist.com

Google and YouTube

Russians behaving badly

The Talibanisation of Somalia?

The ever-adaptable Wallenbergs

Behold: 300m Americans

Who can stop him now?

PRINT EDITION

Full contents
Enlarge current cover
Past issues/regional covers
Subscribe

GLOBAL AGENDA

POLITICS THIS WEEK

BUSINESS THIS WEEK

OPINION
Leaders
Letters

WORLD
United States
The Americas
Asia
Middle East & Africa
Europe
Britain
Country Briefings
Cities Guide

SURVEYS

BUSINESS
Management Reading
Business Education
Executive Dialogue

FINANCE & ECONOMICS
Economics Focus
Economics A-Z

SCIENCE & TECHNOLOGY
Technology Quarterly

PEOPLE
Obituary

BOOKS & ARTS
Style Guide

MARKETS & DATA
Weekly Indicators
Currencies
Big Mac Index

DIVERSIONS

RESEARCH TOOLS

CLASSIFIEDS

DELIVERY OPTIONS
E-mail Newsletters
Mobile Edition
RSS Feeds

ONLINE FEATURES
Cities Guide Go
Country Briefings Go
Audio interviews Go
Classifieds Go

The Economist Group
Economist Intelligence Unit
Economist Conferences
The World In
Intelligent Life
CFO
Roll Call
European Voice
EuroFinance Conferences
Economist Diaries and Business Gifts

Advertisement

Print Edition October 14th 2006

On the cover
America, China and Russia must all make sacrifices to stop a nuclear arms race in Asia and the Middle East: leader

Previous print editions

Oct 7th 2006
Sep 30th 2006
Sep 23rd 2006
Sep 16th 2006
Sep 9th 2006

More print editions and covers »

Subscribe

Subscribe to the print edition
Or buy a Web subscription for full access online

RSS feeds

Receive this page by RSS feed

The world this week

Politics this week
Business this week

Leaders

North Korea
Who can stop him now?

Somalia
Seeking moderates, fearing war

Telecoms
Here we go again, sort of

Ex-communist countries
Europe's fraying fringe

American politics
Crash and re-boot

Letters

On the yen, Egypt, Austin, Sakhalin Island, Iraq, maglev trains, India and China, squash, Canada's native minorities, Ann Richards

Special Report

North Korea
The nightmare comes to pass

Proliferation
A regime as rickety as his own

Correction: Japan's territorial disputes

United States

America's population
Now we are 300,000,000

Ballot initiatives
Questions, questions

Ingenious punishments
Their object all sublime

Wal-Mart
High risk, high reward

Miami
Culture club

Republican difficulties
How goes Ohio?

Lexington
Waiting for the end, boys

Correction: MoveOn.org

The Americas

Ecuador's elections
An enigmatic leftist rides into town

Bolivia
Losing the miners

Mexico
Chemical reaction

Religion in Canada
Coming out

Asia

India's Special Economic Zones
Cash cows

The Philippines
A troublesome priest

South-East Asia
Stuck in a haze

A survey of telecoms convergence

Your television is ringing
All things to all men
The end of the line
Home and away
Tuning in to the future?
Changing the rules
Winners and losers
Sources and acknowledgements
Offer to readers

Business

Google and YouTube
Two kings get together

European television
Regulation without frontiers

Airbus
In place of Streiff

India's acquisition spree
Circle the wagons

Golf in America
Blues on the green

European airlines
The Italian exception

Face value
The media industry's odd man out

Special Report

The Wallenbergs
Sweden's enduring business dynasty

Finance & Economics

China's biggest bank
A dragon stirs

Buttonwood
Roll over

The Nobel prize for economics
A natural choice

Visa's flotation
Plastic coating

Catastrophe insurance
Balmy in Bermuda

Banks and buy-outs
Follow the money

Wine economics
Fruity little numbers

Hedge funds
Back in business

Economics focus
Home truths

Science & Technology

Planetary science
When a world is born

Conservation

Kazakhstan
An apple a day...

Middle East & Africa

Somalia
Islamists half-ready for holy war

Iraq
Divisa in partes tres

The human cost of war in Iraq
Calculating casualties

Gaza
One shrimp at a time

South Africa
Positive dating

Europe

Russia
The hardest word

Central and eastern Europe
Shadows at Europe's heart

France
Sound and fury

Spain
Huddled against the masses

Belgium
Right on

Sweden
Electric power

Charlemagne
The brain business

Britain

National Health Service
Handing over control

Health-care performance
A poor report card

British Muslims
Deconstructing the veil

Children in care
A better deal

Overcrowded prisons
A predictable crisis

Power generation
King Coal redux

Bagehot
An old man who's not in a hurry

Articles flagged with this icon are printed only in the British edition of *The Economist*

Vaccinate in the vales

Cancer therapy
Re-establishing control

Altruism
The joy of giving

Books & Arts

America's mid-term elections
Fighting for votes

New fiction: Martin Amis
Comeback man

Sandy Weill
Big man's shoes

Hewlett-Packard
Her story

Diego Velázquez
His unflinching eye

Obituary

Anna Politkovskaya

Economic and Financial Indicators

Overview
Output, demand and jobs
Prices and wages
Total tax revenues as % of GDP
Money and interest rates
The Economist commodity price index
Stockmarkets
Trade, exchange rates and budgets
General-government structural budget balance

Emerging-Market Indicators

Overview
Bribery
Economy
Financial markets

Advertisement

Classifieds

Jobs	Tenders	Jobs	Tenders	Jobs	Tenders
Senior Forest Policy and Politics Position August 30, 2006 Yale University's School of Forestry & Environm....	Expression of Interest - Management Audit Expression of Interest Management Audit Consultation Company The Tim....	Media Trainers Needed Media Trainers Knight International Journalism Fellowships now open to qualified candidates o....	Request for Proposals: A course on Budget Policies and Investments for Children Request for Proposals:	International Technical Advisor for GEF Protected Areas Biodiversity (PAB) project in Rwanda UNDP seeking an The Un....	Economic Advice to the European Commission (EC) Delegation Kigali, Rwanda Economic Advice to the European Comm....

Sponsors' feature About sponsorship »

Copyright © The Economist Newspaper Limited 2006. All rights reserved. Advertising Info | Legal disclaimer | Accessibility | Privacy policy | Terms & Conditions | Help

Produced by =ECO PDF TEAM=
Thanks xxmama

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Politics this week

Oct 12th 2006
From The Economist print edition

AP

North Korea claimed to have carried out a nuclear test. Russia corroborated the claim, and other regional powers monitored an underground explosion consistent with it. The test was condemned around the world. Japan announced harsh sanctions and America and other countries also threatened them. China, the only country thought to have significant influence with North Korea, called the test a “brazen” act; it was unclear what response it might support. See article

Pakistan condemned North Korea's test as a “destabilising” act. It should know: Pakistan's inaugural nuclear tests in 1998 caused international outrage. In 2004 Abdul Qadeer Khan, the architect of Pakistan's nuclear-arms programme, admitted to having illicitly furnished North Korea, Libya and Iran with nuclear technology.

The British commander of NATO forces in **Afghanistan** held talks with **Pakistan's** President Pervez Musharraf about the Taliban insurgents who have killed dozens of NATO troops in recent months. Some Taliban leaders are believed to be based in northern Pakistan with, some NATO officials claim, the approval of Pakistani intelligence agencies.

Scores of soldiers and Tamil rebels were killed in heavy fighting in **Sri Lanka's** northern Jaffna peninsula. The conflict began the day after the government and rebels agreed a date for peace talks later this month.

The tipping point?

Republicans were embroiled in the fallout from the **Mark Foley** scandal. As the ethics committee in the House of Representatives issued subpoenas in their investigation into the former congressman's communications with teenage pages, Dennis Hastert, the speaker, ignored calls to resign for his handling of the affair. Opinion polls showed a sharp drop in support for the party in next month's mid-term elections. See article

A small plane caused a security scare in **New York** when it crashed into an apartment building. The pilot, a player for the New York Yankees baseball team, and his flight instructor were killed.

AP

In the only television debate in the **California** governor's race, Arnold Schwarzenegger, the incumbent, slugged it out with Phil Angelides, his Democratic opponent. He said Mr Angelides had “joy” in his eyes when he spoke about raising taxes. Mr Angelides did his best to link Mr Schwarzenegger to George Bush, but with the governor far ahead in the polls the chatter probably made little difference.

The government announced plans to crack down on violations of the **trade embargo** on Cuba (sanctions-busting can carry a ten-year jail term). Critics said this was simply a way of propping up the Republican vote in southern Florida.

Health update

Raúl Castro, interim leader of **Cuba**, denied claims by American officials, reported in *Time* magazine, that

his brother, President Fidel Castro, has terminal cancer and will never return to power. The president, who had intestinal surgery in July, was “getting better all the time”, he said.

In the first televised debate between the two remaining candidates in **Brazil's** presidential election, President Luiz Inácio Lula da Silva was put on the defensive by aggressive questioning from the centrist challenger, Geraldo Alckmin, about the corruption scandals that have dogged his four-year term in office.

A grim statistic

A team of American and Iraqi epidemiologists estimated that 650,000 more people have died in **Iraq** since the March 2003 invasion than would have died if there had been no invasion. The Bush administration said the study was flawed. See article

The prospect of war in **Somalia** increased after several hundred **Ethiopian** troops were seen deep inside the country. They support the transitional government that has been losing out to the Islamists, who now control the capital and much of the country. See article

A ceasefire between **Uganda's** government and a rebel group in the north, the Lord's Resistance Army, seemed to be unravelling. Rebel leaders said they would not leave the bush to begin formal peace talks until warrants for their arrest for war crimes, issued by the International Criminal Court, were dropped.

Amnesty International said several thousand child soldiers continue to serve within armed groups in the **Democratic Republic of Congo**, three years after a war was officially declared over.

A long-running feud worsened between the president of **Nigeria**, Olusegun Obasanjo, and his vice-president, Atiku Abubakar, who hopes to contest presidential elections next year. Mr Abubakar has been told to appear in court to answer corruption charges and a close aide was jailed for disclosing classified information.

Death of a heroine

EPA

Anna Politkovskaya, a campaigning Russian journalist who exposed official wrongdoing, was shot dead in Moscow. President Vladimir Putin, visiting Germany four days later, broke his silence on her killing to condemn it, but described her as a person of “minimal influence” in Russian political life. See article

Later, Mr Putin told his hosts that he wanted to make **Germany** into Europe's “gas hub”, but he faced criticism for Russia's human-rights record and treatment of its neighbours. See article

Georgia condemned Russia's deportation of ethnic Georgians, as the two countries' war of words, prompted by a spying row, continued.

The **Czech minority government** resigned after losing a vote of confidence, perpetuating a four-month-old political stalemate produced by a general election in June that resulted in a tie between left and right.

France is to ban smoking in all public places from next February, the prime minister, Dominique de Villepin, announced. Cafés, nightclubs and restaurants must ban smoking by January 2008.

Jack Straw, **Britain's** former foreign secretary, sparked a row when he said he preferred Muslim women not to wear the veil in face-to-face meetings. Some accused Mr Straw of trying to raise his profile because he wants to become deputy leader of the Labour Party. Mr Straw's comments were supported by Gordon Brown, the chancellor and likely successor to Tony Blair. See article

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Business this week

Oct 12th 2006
From The Economist print edition

In what is being hailed as one of the most important deals involving internet businesses, **Google** said it was buying **YouTube**, which hosts videos posted by its online users, for $1.65 billion. YouTube began as a start-up a little more than 18 months ago, but now around 100m of its clips, ranging from segments of films and music to videos of strange vegetables, are viewed each day. Google, which has received mixed reviews of its own online video service, described the partnership with YouTube as “compelling”. See article

There was speculation about what happens next at **General Motors** after Jerry York quit the carmaker's board. Mr York is an adviser to **Kirk Kerkorian**, an investor who owns 9.9% of the company, and was appointed to the board in February after unveiling a set of cost-cutting measures. But since then, relations have soured. Mr York's departure came shortly after GM rejected an alliance with Renault-Nissan proposed by Mr Kerkorian, who is now considering all his options.

ImClone Systems announced the resignation of its chairman and a director, the first apparent victories for **Carl Icahn** in his campaign to shake-up the biomedical company's board. The investor, who owns almost 14% of ImClone and is unhappy with its performance, is seeking to oust several other directors as well.

The Christian thing to do

Airbus's management woes continued when Christian Streiff stepped down as chief executive, with immediate effect, just three months after he was given the job. Appointed after a debacle surrounding delays to the company's signature A380 super-jumbo, Mr Streiff fell out with EADS, Airbus's parent company, over his plans to cut costs and improve performance. Louis Gallois, Mr Streiff's replacement and a co-chief executive at EADS, pledged to continue with the restructuring effort. See article

Visa detailed its restructuring plans. The credit-card issuer said it will launch a public offering in about a year and separate its European unit from its other regional businesses. Currently controlled by a network of banks, Visa follows MasterCard by deciding to float on the stockmarket. See article

The politics of energy

Gazprom, Russia's gas monopolist, decided that it would develop the Shtokman natural-gas field on its own, a blow to five Western oil companies that had been shortlisted for a stake in the $20 billion Barents Sea project. The state-controlled firm also said priority in output from the field would be given to European pipeline deliveries over LNG shipments, a snub to America for dawdling over Russia's accession to the World Trade Organisation.

RUSAL took the wraps off its much-trailed plan to merge with **SUAL**, its Russian compatriot, and take over the aluminium assets of **Glencore**, a Swiss commodities group. Valued at up to $30 billion, United Company RUSAL will produce around 4m tonnes of aluminium a year, vaulting it ahead of Alcoa as the world's biggest aluminium company.

Cablevision Systems received a $7.9 billion buy-out offer from Charles and James Dolan, respectively its chairman and chief executive. The Dolan family controls Cablevision, which counts the New York Knicks basketball team among its assets, and has toyed with breaking up the firm.

PNC, a Pittsburgh bank, agreed to buy **Mercantile Bankshares** for $6 billion, so reaching into the lucrative market of metropolitan Washington, DC.

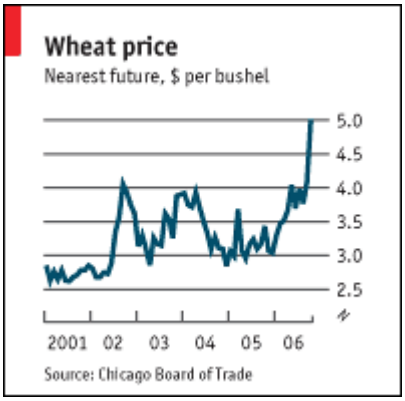
France's **Crédit Agricole** agreed to buy 654 bank branches from **Banca Intesa** for *euro*6 billion ($7.5 billion). The acquisition arises from Intesa's merger with Sanpaolo, an Italian compatriot; Agricole is Intesa's largest shareholder.

There were more corporate casualties related to **stock-option** practices. The chief executive of job website **Monster.com's** parent company stepped down saying he could no longer combine the job with a review into the company's share-options policy. And the bosses of **McAfee**, a maker of anti-virus software, and CNET, an online technology magazine, resigned because of shenanigans stemming from backdated options.

It emerged that **Industrial and Commercial Bank of China** expects to raise around $22 billion from its forthcoming dual listing in Hong Kong and Shanghai. This would make the sale the world's biggest-ever public offering. See article

Cereal killer

Wheat prices continued to rise as a drought in Australia, the third-biggest producer of the grain, showed little sign of easing. With low stockpiles in America, analysts are expecting an upward tick in the price of foods such as bread, breakfast cereals and pasta.



Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

North Korea

Who can stop him now?

Oct 12th 2006
From The Economist print edition

America, China and Russia must all make sacrifices to stop a nuclear arms race in Asia and the Middle East

WITH the possible exception of South Africa, no country that has tested an atomic bomb has given its nuclear weapons up. So no matter what the world now does to punish North Korea for its underground test on October 8th, Kim Jong Il's hermit kingdom is likely to hang grimly on to its bomb. If you are the paranoid dictator of a friendless state that is still technically at war with both South Korea and the United States, a nuclear arsenal is your ultimate insurance policy.

To say this is not to say that North Korea should go unpunished. On the contrary, it must be punished even if the punishment is unlikely to change its ways. That is because other would-be nuclear proliferators, with Iran to the fore, are now watching to see whether it is really as easy as Mr Kim has made it look to go nuclear in defiance not only of the dire warnings of the United States and the United Nations but also of powerful neighbours such as Russia and China.

In New York the UN Security Council denounced the North Korean test. George Bush refuses to take any option off the table, implying a readiness to react with military force. Yet America has few military options. Even without nuclear weapons, Mr Kim in effect holds the South Korean capital, Seoul, hostage: his conventional rockets and artillery could rapidly flatten much of the city, killing tens of thousands. And although the Americans could bomb the North's reactors, they do not seem to know where the regime hides its fissile materials and any bombs it has made from them.

Mr Kim places a bet

Hopes of applying tough new pressure on Mr Kim therefore rest mainly on China. The Chinese could, if they wished, starve North Korea's people and switch off its lights. They are also very angry. Having denounced Mr Kim's “brazen” disregard of world opinion, China went on to speak for the first time of the need for (“appropriate”) punitive action (see article). But Mr Kim, for all his megalomania and paranoia, is a shrewd tactician. He has evidently made a bet with himself that for all their huffing and puffing the Chinese will not in the end want to blow his regime down. And he may be right.

A strategy of sanctions has two weaknesses. One is that Mr Kim, who has already presided nonchalantly over mass starvation inside his country, cares little about the suffering of his own people; he knows that China knows it could cut off his fuel and food and still not force him to give up his bomb. The other is

that really harsh sanctions might bring about the sudden collapse of his regime. And however angry China may be about Mr Kim's bomb, it has so far sadly seemed much more anxious to ensure that his regime does not collapse.

Why so? The main threat a North Korean bomb poses to China is indirect: it might persuade Japan to arm itself with nuclear weapons too, though Japan rules this out for now. By contrast, both China and South Korea would face immediate consequences if Mr Kim's regime imploded. Fine if an orderly coup installed a more pliant government, or if (the blithe hope underpinning the South's "sunshine policy") the North could be guided gradually towards political openness and economic sanity. But a sudden collapse could be highly unpredictable and perhaps violent, spilling millions of desperate refugees into both China and South Korea and lumbering both with the vast, unwanted expense of rescue or reunification.

Push harder—but provide an escape route

In 2002 Mr Bush lumped Iraq, North Korea and Iran together in an "axis of evil" and said he would stop them acquiring nuclear weapons. He implied that regime change in Iraq might be followed by regime change in North Korea and Iran. Now one says it has the bomb and the other is ignoring Security Council orders to stop enriching uranium. The anti-proliferation policy Mr Bush put at the forefront of his foreign policy has been a colossal failure. Is there any way to turn it round?

Not if the big powers follow Mr Kim's script. He plainly expects them to wax briefly indignant but then shrug their shoulders and learn to live with his bomb, just as they live with those of Israel, India and Pakistan. Mr Kim says it was America's threats that made him seek a deterrent. Some will cite this as proof that a policy of sanctions is self-defeating.

But this is a misunderstanding. Since Iraq, Mr Bush has tried to build coalitions against proliferation. China took the lead in the six-country talks on North Korea; Britain, France and Germany took the lead on Iran. The trouble is that when persuasion has failed the other big powers have refused to apply pressure. China is set on protecting Mr Kim, and both China and Russia are pathetically reluctant to clamp even mild sanctions on a rising, energy-rich power such as Iran.

If the world is to prevent the spread of nuclear weapons, the Russians and Chinese will have to give up some serious interests in order to cause real pain to proliferators. Good relations with Iran are worth sacrificing for the bigger aim of preventing a chain reaction of proliferation across the Middle East. As for Mr Kim, the moment has come for his neighbours to see the folly of paying for short-term stability by propping up a dictator who has slipped dangerously out of control, and whose nuclear delinquency threatens to spark a much wider nuclear arms race in Asia. That would be in nobody's interest. Both China and South Korea ought now to follow Japan and back tough sanctions even if these do topple the regime. It will fall one day anyway, and this is the time to prepare.

America may need to make sacrifices too. It was not Mr Bush who sent North Korea and Iran on their nuclear trajectories: both started their programmes decades ago. But such regimes need to believe that they can desist and still be safe. Tough sanctions must therefore be coupled with clearer incentives. Mr Bush has already told both governments he has no desire to remove them. If they need stronger guarantees he should give them—in return for a verifiable end to their weapons programmes. It will not be easy for a president who wanted to spread democracy to do this. But that, in an imperfect world, may be the price of preventing dictators from controlling the weapons that could kill millions.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Somalia

Seeking moderates, fearing war

Oct 12th 2006
From The Economist print edition

Looking for the least bad option in a place with a few similarities to the Taliban's Afghanistan

Get article background

THE situation may sound familiar. A failed state, where clans and warlords have torn the territory to shreds, is after 15 years of anarchy at last offered the chance of order, unity and stable rule. The problem? The new rulers are gun-toting Islamists who issue and enforce strict religious decrees and who are thought to have links to terrorist groups, perhaps including al-Qaeda. It may sound like Afghanistan under the Taliban. In fact it is Somalia today.

Outsiders face only a few choices in Somalia, none of them particularly appealing. One is to do nothing and let the Islamists try to take over the entire country and rule as they wish. They already control the capital, Mogadishu, and in the past few months have seized most of the centre and south. Another is to intervene, overthrow the Islamists and install a sympathetic government. But that looks a flight of fancy: remember the failure of American troops who tried to deliver aid to Mogadishu in the early 1990s (or, for that matter, the current woes of foreign soldiers in Iraq and Afghanistan).

A middle path—a half-hearted intervention—would be the worst of all options. Yet this week Ethiopia, the regional power, seemed to be trying just that. On October 9th several hundred Ethiopian troops were reported to be deep inside Somalia, pushing back an Islamist army towards Mogadishu (see article). This year America lent clumsy support to Ethiopian-backed Somali groups opposing the Islamists, possibly breaking a UN arms embargo. Stepping in to encourage the fighting, but without acting decisively, merely strengthens extremists over relatively moderate leaders among the Islamists in Mogadishu. A jihadist fringe has been itching for a “holy war”, which may mean terrorist attacks, against Ethiopia and other Western allies. This week, in response to Ethiopia's invasion, some Islamists made precisely such a call for *jihad*.

Worse, Ethiopia's intervention raises the prospect of a wider conflict. Ethiopia is partly motivated by a wish to hit its old foe, Eritrea, which is thought to be supporting and arming the Islamists. The risk of a regional war, fought by proxy inside Somalia, is real. The risk to neighbours is serious too. America is paying to beef up security on Kenya's northern border. Refugees are flowing out of Somalia. The African Union is fretting, with some members even suggesting a peacekeeping force be deployed to Somalia.

If you can't beat 'em, seek out the moderates

But there is a final option that is still worth considering. There can be no proper government in Somalia without the co-operation of the strongest force, the Islamists. Ethiopia and others may well prefer to see a weak and wretched Somalia rather than a united and Islamist one. They are wrong.

The Islamists in Mogadishu are not uniformly extreme. The comparison to the Taliban, though superficially attractive, is somewhat misleading. Some elements are abhorrent, ordering rough justice, summary execution of criminals and issuing severe religious decrees. But for the moment they are a minority. There are also relatively moderate Islamist leaders who could be coaxed by donors such as the European Union to talk about sharing power with the rump of an (Ethiopian-backed) transitional government that controls a part of Somalia near Ethiopia. Peace talks are scheduled for the end of the month, in Sudan. Talking to Islamist rulers may be an unpalatable choice. But it is the least bad one.

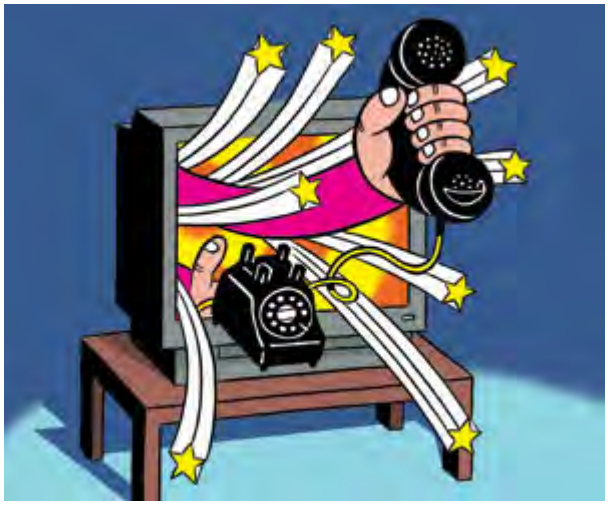
Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Telecoms

Here we go again, sort of

Oct 12th 2006
From The Economist print edition

Is the mania for "convergence" another case of mass hysteria in the telecoms industry?



STOP us if you've heard this one before. The trillion-dollar telecoms industry is caught up in a frenzy of dealmaking and network construction. It believes it has hit upon a brilliant strategy to deliver exciting new services and guarantee future growth. Yes, this involves spending huge amounts of money, but it will be worth it in the end. Only those who embrace the new vision will prosper; others will be left behind.

This was the scenario in the late 1990s, when dozens of companies with identical business plans set out to build whizzy new fibre-optic networks to handle the coming deluge of internet traffic, which was widely (and wrongly) believed to be doubling in volume every 100 days. It is also what happened in 2000, when mobile operators in Europe paid fantastic sums for licences to build third-generation (3G) mobile networks, which would be used to deliver video calls and other exciting data services to eager consumers. Alas, both lots of plans proved to be wildly over-optimistic, and a huge crash ensued. As our survey this week explains, the industry is up to its old tricks again. Its new mantra is "convergence". Is this just another collective delusion that will end in tears?

As with the fibre build-out and the 3G mania, the convergence craze is predicated on the exciting possibilities opened up by new technology. The spread of internet standards means that voice, video and broadband, which were previously distinct services delivered over separate networks by phone companies, cable and satellite operators and internet-service providers, have all turned out to be the same thing, namely streams of ones and zeroes. As a result, the distinctions between previously separate industries are dissolving, and all these firms are moving onto each other's turf, offering "bundles" of telephone, broadband and television services.

Not everyone's a winner

The prospect of being able to enter new markets is one factor that makes convergence an attractive strategy, but there are others. Telecoms firms regard convergence, and a move into television services in particular, as the best defence against declining revenues from fixed-line phone calls and the migration of traffic to mobile networks. Cable-TV operators hope that offering bundles including cheap phone calls will prevent customers defecting to their rivals' television services. There are also savings to be made by

replacing many separate networks with a single “next generation” network, which enables firms to launch new services more quickly. And once customers have signed up for a bundle of services, they are less likely to be lured away by a rival. Convergence can even make possible clever new services, such as phones that hop seamlessly between fixed and mobile networks, or videoconferencing through your television.

It all sounds brilliant. But there are good reasons to think that the industry is again being over-optimistic. For one thing, surveys of customers suggest that not everyone wants to buy a bundle of services from one company, even when offered a discount: they may instead wish to pick and choose services from different providers. Another problem with convergence is that everyone is doing it—and, by definition, not every firm can be more competitive, more agile and more able to attract and retain customers than the rest.

Nor do new converged services seem very likely to generate much extra revenue. Household spending on communications and entertainment in the developed world grew during the 1990s, as everyone signed up for mobile phones and broadband, but is now flat, so the coming battle between converged operators will really be a fight for market share. Proponents of convergence insist that the new networks' support for “video on demand”—the ability to call up television programmes and films at will—opens up a lucrative market. But just as voice-over-internet technology, such as Skype, decoupled phone calls from phone wires, it seems likely that YouTube (bought by Google this week for $1.65 billion) and other internet-video services will decouple television service from broadband pipes. So even if video on demand does prove popular, the network owners may not benefit from it.

Convergence does have some merits then—mainly in cutting costs and increasing efficiency—but the hype is wide of the mark. Its chief significance is that it heralds the advent of far more vigorous competition in the telecoms industry. It will be a bloody fight for the companies involved, but the ultimate victors will be their customers, who will benefit from greater choice and lower prices.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Ex-communist countries

Europe's fraying fringe

Oct 12th 2006
From The Economist print edition

Time to worry about the governments of eastern Europe—especially with Russia in the wings

BAD, weak, timid government in Europe is, sadly, nothing new. And few outsiders are in a position to preach to the countries of the east, which have so wrenchingly changed since the collapse of communism, and are now the continent's fastest-growing part. But their continued growth needs more reform, and that, crucially, depends on better government.

Travel the ex-communist region between the Baltic, Black and Adriatic seas, and, sadly, you will not find one united, modernising government. Instead, there is sleaze and racism in Slovakia's government, eccentricity and petulant incompetence in Poland, an admission of blatant lying by Hungary's prime minister, and no government at all in the Czech Republic. Throughout the region, communist dictatorship has all too often given way to incompetence and corruption, not the yearned-for freedom and the rule of law.

Decades of totalitarian rule damaged the way people in power think and behave; and the harm has not been repaired. Getting into the European Union and NATO transformed parts of national life in the new member states, but left swathes untouched, particularly bits run by the state. Schools and universities, for example, are vital for the shift to an economy driven by brainpower instead of cheap labour, but they remain state-run, rigid and mediocre.

Eastern Europe's remarkable political failure (see article) matters not just because of economics. Weak, deceitful, clownish, boorish, squabbling, thuggish and corrupt politicians in the east risk destroying the flagging enthusiasm of west European voters for further enlargement of the EU. Yet the “European perspective”, as the bureaucrats call the chance of membership, is the one thing tugging the bruised and battered countries of ex-Yugoslavia towards peace and co-operation. Without it, conflicts will flare up unchecked, at best local, at worst turning into wider conflagrations.

Heavyweights in the wrong ring

The ex-communist countries still have some heavyweight politicians and officials—but they are not in power. Some are on the lecture circuit. Others have gone to well-paid but peripheral jobs in Brussels. They stand out there, but would be even better heading home to sort out the mess. Toomas Hendrick Ilves, vice-chair of the European Parliament's foreign-affairs committee, has just run successfully for president of his native Estonia. Others should follow his example.

If better leaders would help, so would better role models. Central European countries have tended, consciously or not, to look to Austria, and so politicised their civil services and encouraged cosy links between business and government. (The Baltic states, by contrast, have looked to the more open, transparent Nordic countries, such as Finland—with spectacular results.) And Western Europe could do more. The mean-minded protectionism aimed at the ex-communist countries has undermined belief in the fairness and neutrality of European rules. Why can rich countries' banks move capital freely throughout the single market, when poor countries' plumbers and dentists may not sell their services where they like?

It is tempting to argue for patience. A middle class is developing; minds are opening; piecemeal reforms are continuing; the division of the continent is healing. The latest shenanigans may be unpleasant, but are they not just teething pains in young democracies?

Perhaps. But now there is another factor: Russia. The past week has seen more signs of Russia's slide into state-sponsored gangsterism (see article). Whether as a direct result of this or not, Russia's best-known independent journalist, Anna Politkovskaya, was murdered on October 7th (see article).

Russian menace and muscle change the geopolitical rules for the Soviet Union's former satellites, both those sheltered by the EU and NATO and those outside. In one sense Russia is still weak: its state institutions are bloated and incompetent; its population is collapsing, its economy woefully dependent on natural resources. But it increasingly has the ability to create mayhem in what the Kremlin terms the “near abroad”.

Russian oil-and-gas companies have bought up large chunks of energy industries in eastern Europe and are trying to buy more. When Russia seemed weak and friendly, that was a minor worry. Now it is a big one. Business footholds can soon become political bridgeheads, which coupled with weak politics creates a vulnerability to Russian influence-peddling and mischief-making. A new cold war? Not yet. But eastern Europe's drift and complacency have never been riskier.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

American politics

Crash and re-boot

Oct 12th 2006
From The Economist print edition

The wrong kind of voting machine could bring chaos to the mid-term elections

Reuters

THE polls go up, the polls go down and there are still more than three weeks to go: time for any amount of sleaze or terror to influence the voters. But it is quite possible that America's mid-term elections on November 7th will produce a close result, not just in the House of Representatives, where it has long been predicted, but in the Senate too. At which point things could get fraught.

The problem is voting machines. Not the ones with hole-punches and their chads, hanging, swinging and dimpled. Since the debacle of 2000 in Florida federal money to the tune of several billion dollars has been lavished on replacing them. Unfortunately, many have been replaced with new ones that may be even worse. In a close election the prospect of just a handful of the 435 House seats or one or two of the 33 Senate seats at stake being furiously challenged in court is all too plausible. Like the presidency in 2000, the colour of Congress could have to be decided by lawyers.

How could this have happened? Mainly because lots of states and counties went for touch-screen devices, very like ATMs, instead of a much better alternative, optical scanners that count votes marked by hand on paper ballots, rather like lottery forms or multiple-choice exam papers. The good thing about scanners is that the original ballot is by definition available for re-counting. With touch-screens, it isn't. Fortunately, more than half of America's 3,000-odd counties have opted for scanners. But about a third have chosen the touch-screens.

A thermal printer to produce a record is available as an added extra on some touch-screen machines. But when these were tried out, as they have been across the country in primary elections in the past few months, the results were not encouraging. If the paper is put in wrongly, the printer does not print at all. Even when it was the right way round, there were many cases of the paper jamming, tearing or producing unreadable results. The fact that most election officials are unpaid volunteers, very often elderly and with little or no training, also caused difficulties. At any rate, with a touch-screen system the paper-trail is produced by the machine, and so is only as good as the machine. And the machines, it also turns out, may be vulnerable to tampering.

In September three scientists at Princeton University got hold of the most popular touch-screen model and took it and its software to bits. They found serious flaws allowing a competent hacker to infect the machine with a program to transfer votes from one candidate to another. Such a change could be

undetectable without a recount (assuming one were possible), and the program could be introduced into the machine far in advance by anyone having access to the machine's memory-card reader for as little as a minute. The readers are protected by a lock, but the lock is a standard one, and keys can be bought on the internet: besides, the keys circulate among election officials. And the researchers found that their program could be spread from machine to machine via the memory-cards. Voting-machine companies make things worse by keeping their software secret: were it published, security experts would be able to assess it and recommend fixes.

Pray for a clear result—and then buy some decent kit

Many people will see this as a conspiracy too far, and perhaps it is. But another problem is that the machines used at polling stations have a tendency to break down. Avi Rubin, a computer science professor at Johns Hopkins University who is also an election volunteer, has blogged scarily about his experiences at the primaries in Maryland. (In his case, most of the problems occurred not with the voting machines but with other terminals, designed to ensure that people are entitled to vote and have not voted twice.) Elsewhere, there have been horror stories of votes failing to register or upload, of memory-cards going missing, and of machines crashing and losing stored votes. Only a few such cases can damage confidence badly: and crashes, at the least, cause huge delays.

The solutions are not hard to find: a wholesale switch to paper ballots and optical scanners; more training for election officials; and open access to machine software. But it is too late for any of that this time—and that is a scandal.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

On the yen, Egypt, Austin, Sakhalin Island, Iraq, maglev trains, India and China, squash, Canada's native minorities, Ann Richards

Oct 12th 2006
From The Economist print edition

The Economist, 25 St James's Street, London SW1A 1HG
FAX: 020 7839 2968 E-MAIL: letters@economist.com

An undervalued argument

SIR – It is quite right to spotlight the yen as the world's most mispriced currency, but in many ways your article did not go far enough in pointing out the seriousness of the potential implications ("Yen and yang", September 30th). Along with many observers, you note that there has been no intervention to weaken the yen since 2004. But this ignores the massive scale of intervention up until March 2004, and the moral hazard thus created, which made the yen "carry trade" look like free money to many global speculators. Even if those of us who believe that the carry trade is responsible for the yen's weakness are wrong, and alternative explanations, such as that of Morgan Stanley's Stephen Jen, are right, the mispriced yen is a very clear sign that something has gone seriously awry with the way global financial markets are working in relation to global imbalances.

Your point that the yen is now much lower in real terms than in 1985, when the G7 took action to address a dollar bubble and global imbalances that were much smaller than today's, is instructive. The G7 may have made some mistakes in the 1980s, but there was a political will to deal with economic problems that seems to be completely lacking at present. We can be sure that the world is eventually going to pay a very heavy price for this neglect of responsibility.

Tim Lee
pi Economics
Stamford, Connecticut

Egypt's power play

SIR – Your analysis of Gamal Mubarak's interest in Egypt's peaceful nuclear ambitions only touched on the benefit the president's son stands to gain from an enhanced image in the Arab world ("Nuclear succession", September 30th). Mahmoud Ahmadinejad and Hassan Nasrallah owe their popularity to the simple fact that they defied America. Although Egypt is probably serious about limiting its nuclear intentions to peaceful applications, the perception on the street is that, eventually, it will become a nuclear power. Long seen as an American lackey, the younger Mubarak has probably decided it is time to make amends.

Hassan Elsawaf
Cairo

Austin's planned economy

SIR – It is misleading to suggest that the development of the high-tech business cluster around Austin began with IBM in 1967 ("Blame it on the typewriter", September 23rd). The region's initial electronics capabilities stem from the Balcones Research Centre, established in 1946, which carried out government-supported defence and electronics research. Out of this came Tracor, a big defence company that itself spun off some 20 technology related firms.

Moreover, Austin's transformation was not simply the outcome of free-market luck. Rather, it came from the efforts of local leaders, the University of Texas at Austin and others, who have been successful in combining local research strengths with intelligent federal subsidies.

Tijs Creutzberg
Toronto

Energy reserve

SIR – You rightfully acknowledge the legitimacy of environmental concerns about Shell's project on Sakhalin Island, yet you question the motivation of the Russian government for enforcing its environmental regulations ("Yukos revisited?", September 23rd). Why is there no criticism of Shell for damaging the environment so badly that such intervention is needed?

Independent Russian and international organisations monitoring Shell's project have documented a consistent pattern of environmental violations for years. These are not limited to a failure to control contractors, but include fundamental assessment and design flaws that began at the project's conception and will cause damage to the environment throughout its lifespan.

Moreover, Shell's staggering cost overrun will deprive the Russian government of billions of dollars in promised revenues from the project. If, as you suggest, this imbroglio dampens the investment climate in Russia for other companies (and especially those in the natural-resources sector), people will blame Shell for ruining things for those still to come.

Doug Norlen
Policy director
Pacific Environment
San Francisco

Battling on

SIR – So the National Intelligence Estimate's assertion that the Iraq war has exacerbated terrorism would only be dismissed by "the wilfully dim-sighted" ("Stating the obvious", September 30th). As you supported the incursion in the run-up to the war, and many times since, are you included among the visually impaired? I haven't noticed any Manhattan skyscrapers burning lately. The sad fact is that jihadists will use any reason to spread their murder and mayhem. Had we left Iraq unmolested they would have incinerated the innocent on behalf of Chechnya, Palestine, etc, on whatever rationale they found in the day's news.

Terry Nugent
La Grange Highlands, Illinois

SIR – By concentrating on the number of troops that are required to prevail in Iraq, one loses sight of the conundrum of how to prevail. The Bush administration has also failed to address this question, as evidenced by its string of excuses for the war, including the current favourite, an ideological struggle with fascist Islam. Without a clear objective for going to war, a strategy for winning the war remains elusive and adequate military resources cannot be allocated: this is the lesson of Vietnam. Unfortunately, the only strategy this administration has effectively formulated for Iraq is a campaign strategy.

Thomas Schild
New York

Wheel of fortune

SIR – If German and Japanese taxpayers wish to support the development of high-speed magnetic levitation (maglev) trains it is up to them ("Still aloft, just", September 30th). However, maglev railway has for years been a discredited solution seeking a problem. In Britain such a project would be a folly and a bigger waste of money (and political capital) than Concorde or the Millennium Dome.

On railways the wheel is not the problem and it should not be replaced with more complex and energy-consuming maglev systems that require vast additional investments. The wheel is a remarkable piece of technology, simple in principle and effective at speeds adequate for high-speed trains. The real challenge is in the track: high speeds need relatively straight tracks and lots of land. Therefore our focus should be on making a high-speed train that is as environmentally benign and economic as possible.

Trains are designed for transport, not to provide electrical and mechanical engineers with futile

intellectual challenges. Is there any point in imposing a huge extra burden on taxpayers and pension funds to save a few minutes (perhaps) for a few travellers?

John Emanuel
Chairman
UTEK Europe
Berkhamsted, Hertfordshire

Captured markets

SIR – How can your leader on the changing balance of economic power in the world claim that "technology and a spirit of freedom enabled the West to leap ahead" of India and China in the mid-19th century ("Surprise!", September 16th)? In reality, it was the West's imperial, and often violent, interventions and controls on these two countries that were instrumental in stultifying their economic development. India, for example, had the most advanced steel and textile industries at the beginning of the 19th century. Britain pirated India's technology, shut much of its advanced industries and forbade its exports, forcing it to buy second-rate British products in a closed market. Fertile land was stolen from Indian food farmers and converted to growing opium, which was then forced on the Chinese. Similar situations were repeated in other Asian, African and Latin American countries. In telling the whole story of the West's success, one must talk of stolen resources, forced foreign labour, and suppressed competition from the colonies.

Hendrik Weiler
Cairo

The education racket

SIR – Lexington should be applauded for examining the ways in which the admissions policies of America's elite universities give unfair advantage to the privileged (September 23rd). I benefited from this system, attending a private school before being recruited by Harvard to play squash, one of the "preppie sports" often used by the rich as a "hook" in the college application process. However, sports like squash, golf, fencing and lacrosse are now being introduced in poor communities. Take squash for instance, where $20m has been donated to inner-city programmes in the past decade: last year the top squash recruit at Wesleyan came from Harlem. At the CitySquash after-school programme I run in the Bronx, 45% of the middle-school graduates have won scholarships to prep schools.

Tim Wyant
Executive director
CitySquash
New York

Minority status

SIR – The principal reason why Canada's aboriginal policy has failed is the unrealistic and unreasonable basis of aboriginal rights ("This land is my land", September 16th). These are special rights ceded to native minorities simply for having arrived here earlier, but they are rights which are also incompatible with existing federal and provincial legislation on issues such as resource development. Moreover, natives have no moral claim to these rights. The group of First Nations are demanding rights that they denied each other historically. Elaborate warrior cultures attest that conflict and conquest were rampant in pre-Columbian times and there certainly was no conception of dominant newcomers respecting the rights of people who were already there. This does not imply that Canada's First Nations have no legitimate grievances, but settlements should be based on need, common sense and fairness to all Canadians, not on special rights for the few or to right historical wrongs.

Joseph Bako
Vancouver

A good ol' gal

SIR – Ann Richards addressed our daughter's graduating class at the all-female Smith College in 1992 (Obituary, September 30th). Although regally gowned for her honorary doctorate, Mrs Richards confessed that her big white hair stopped her from wearing the cap. Her speech was both stirring and

jocular, and her telling humour stood out: “My most difficult challenge in Texan politics was to teach men to make the coffee.”

Roger and Jil Brosnahan
San Miguel de Allende, Mexico

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com SPECIAL
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

North Korea

The nightmare comes to pass

Oct 12th 2006 | BEIJING, SEOUL AND TOKYO
From The Economist print edition

Now that North Korea has carried out a nuclear test, can anything be done to punish it? Or would the collapse of the regime be even more dangerous?

Getty Images

THE reaction was swift, furious and unanimous. North Korea's (claimed) nuclear test on October 9th was “brazen”, said the Chinese government—unusually harsh words from North Korea's biggest provider of aid, and its only friend. “Unacceptable” and “provocative”, said President George Bush. He had talked to the leaders of Russia, China, South Korea and Japan; all had agreed that an “immediate response” was called for.

But what? The cries of outrage were followed by humming and shuffling—except in Japan, which almost immediately cut off trade. America's secretary of state, Condoleezza Rice, having stressed there would be no attack on Pyongyang, added that the North Koreans would now face sanctions “unlike anything they have faced before”. But might a more isolated North Korea behave even more badly? Or might sanctions trigger its collapse, bringing a flood of refugees and unleashing nuclear mayhem?

On October 11th the UN Security Council was still discussing what sanctions to impose. America wants international inspections of all cargo moving in or out of North Korea, and the freezing of North Korean assets linked to illicit activities. China, while anxious to exclude any threat of military force and keen to limit the scope of sanctions, showed unusual willingness to talk about such things. It may even scrap a “treaty of friendship” signed with North Korea in 1961, which commits China to defending North Korea if it is attacked.

Exactly what happened at the underground site about 110km (70 miles) from the Chinese border at 10.36am local time on Monday remains unclear. Experts believe that, for a nuclear explosion, it was unusually small. But whether or not it was as successful as claimed, the timing of the blast annoyed China intensely. Hu Jintao, its president, had only just agreed with Shinzo Abe, Japan's new leader—at the first summit between the two countries for five prickly years—that a North Korean nuclear test would be “unacceptable”. Mr Abe's prescient summitry has gained him much respect in the region and at home, but China has been caught on the back foot.

North Korea's only courtesy to its ally was a 20-minute warning of the test. For a country that sacrificed

hundreds of thousands of lives to help North Korea in the war of 1950-53 and that has been a crucial provider of food and fuel during North Korea's recent years of economic disarray, this was a poke in the eye. China's patient efforts since 2003 to host “six-party talks” on North Korea's nuclear programme with North Korea, South Korea, Japan, Russia and America—an unusually assertive step by China to solve an international crisis—were shown to be a complete failure.

But for all its anger, China remains deeply worried about any move that might cause instability in North Korea, with which it shares a 1,400km border. So too does South Korea. Even before the emergence of a nuclear threat, South Korea still faced a 1.1m-strong North Korean army, most of which is deployed close to the south and which, with artillery shells and conventional missiles, could quickly devastate Seoul, the capital. It also faces, in North Korea, the world's largest active chemical and biological armoury.

Much as it resents the behaviour of North Korea's Kim Jong Il, China is not pushing for regime change. Jasper Becker, the author of a recent book on North Korea, claims that China made contingency plans for a possible invasion of North Korea three years ago when it worried that America might launch a strike against North Korea's nuclear facilities. The aim would have been to install a pro-China government that would forsake nuclear weapons. But Mr Becker says China's military chiefs concluded it could not be done.

China is not at all convinced that an escalation of sanctions would help either. Yan Xuetong of Tsinghua University says this could simply provoke an embattled North Korea into conducting more tests in order to perfect its nuclear deterrent. He says it is in China's interests to have a government in North Korea that is hostile to America: this reduces America's flexibility in any military response to a crisis in the Taiwan Strait. In Mr Yan's view, China's outrage at North Korea's test is similar to that of France and Germany over America's invasion of Iraq in 2003. Although it strained relations, “they are still allies.”

If Kim falls

In discussions with America about how to handle North Korea, China has emphasised that talk of regime change is taboo. If word of such a conversation were to leak to the North Koreans, it fears, this would destroy whatever trust they have in China and any chance of a negotiated settlement.

But whether or not the sanctions under discussion are intended to bring Mr Kim down, his regime might collapse anyway. Without reliable statistics it is hard to be certain; but it seems that though North Korea has recovered somewhat from a tailspin in the 1990s, including a famine that killed as many as 3m people, it is still growing at a snail's pace. Much of its industry remains in tatters. The International Crisis Group, an NGO, says in a new report that North Korea's food supplies are stable now because of a decent harvest last year, despite floods this summer that destroyed crops and killed several hundred people. But it stresses that the country is unlikely to be self-sufficient in grain for the foreseeable future, and that the risk of food shortages is growing—not least because food aid, fully half of which comes in from China and South Korea, may now dwindle. An economic collapse could create instability, even civil war, for which none of the powers involved is prepared. South Korea, in particular, dreads the cost of rebuilding the North.

China and America have shown no sign of talking, let alone agreeing, on how to handle a collapse of the regime. China might decide to send troops across the border, in order to staunch a refugee exodus on North Korea's territory rather than its own. It might even want to take full control of the North. But how this would be co-ordinated with any plans by South Korea and America to intervene has not been worked out. Rival foreign armies might find themselves in conflict. Ralph Cossa, of the Pacific Forum of the Centre for Strategic and International Studies, says the Americans would probably prefer to stand back and let South Korean forces cross the border. Others say that the Americans expect to be first across, and with very messy fighting and humanitarian work to do.

Pushing for regime change is still better than accepting North Korea as a nuclear power, in Mr Cossa's view. In addition to cutting off oil supplies and food aid, other than contributions through the World Food Programme (WFP), China should open its borders to North Korean refugees. The resulting exodus, he says, would prompt “serious thinking” in Pyongyang.

China, however, would not think much of this plan. In recent years it has struggled to deter famished North Koreans from venturing across the border. Those found are sent back to North Korea, where they are often imprisoned or even executed. A few have succeeded in getting into foreign diplomatic missions, which have arranged with China for their safe passage to other countries. But in recent years China has set more armed guards and barbed wire around embassies and consulates to stop such attempts.

Apart from not wanting to irritate North Korea, with which it has an agreement to repatriate refugees, China fears that a flood of desperate North Korean asylum-seekers would destabilise its north-eastern provinces. Widespread lay-offs from state-owned enterprises have already caused dissension there. Perhaps 50,000-300,000 North Koreans are hiding in north-eastern China, a number that would surge massively if the border were opened. China fears that a big increase in the number of ethnic Koreans in the border region could, in the long run, raise demands there for secession from China and integration into a united Korea.

An ancient grievance

Although China's ties with South Korea have rapidly improved in recent years, with South Korea now accounting for more than 8.5% of foreign direct investment in China in non-financial sectors (just behind Japan), China worries that a united Korea would be awkward to deal with. Already in South Korea, despite the two countries' often similar feelings about North Korea, anti-Chinese sentiment is easily aroused. In 1895 China lost a war with Japan for control of Korea, which had been under China's sway. Many Koreans suspect that China wants to dominate the peninsula again, as a useful buffer against a more assertive Japan.

South Koreans have been outraged by China's efforts to portray the ancient kingdom of Kogoryo, which Koreans see as a forerunner of their modern state, as Chinese. Kogoryo stretched from north-east China to North Korea, prompting some to speculate that China's claim to it presages designs on the northern part of the peninsula. South Korea's president, Roh Moo-hyun, is due to visit Beijing on October 13th. Ancient history is on his agenda.

South Korea would agree with China, however, that wide-ranging economic sanctions against the North would not be helpful. In July China agreed for the first time to sanctions by accepting a UN resolution that condemned North Korea's missile tests that month and called for a halt to any trade with the North in missile technology. Earlier this year, the state-owned Bank of China froze North Korean assets in its Macau branch in response to an American initiative to clamp down on North Korea's use of foreign bank accounts to launder illicit money. And although China is secretive about its food aid to North Korea, WFP officials believe shipments have fallen sharply this year. South Korea suspended its direct food aid to the North after the missile tests.

But China and South Korea have other economic interests in North Korea that have been expanding even as the nuclear dispute has continued to worsen. Chinese companies have been hungrily eyeing North Korea's mineral reserves, from iron ore to coal and gold. With its mining sector hampered by outdated technology and poor infrastructure, North Korea has welcomed approaches by Chinese companies hungry for resources to feed China's industrial boom. Details are difficult to obtain. But Chinese media said last year that Chinese state-owned companies were proposing to invest more than $880m in North Korea's Musan iron-ore mine near the Chinese border. The South Koreans too have shown little inclination to sever their economic interests. Business has continued at its showcase projects with the North, the Kaesong economic zone—where workers hand-picked by the North Koreans work for South Korean enterprises—and the Mount Kumgang tourist enclave, both cash cows for the Kim regime.

Seoul's sunshine, Tokyo's toughness

Mr Roh acknowledged after the test that the South's “sunshine policy” towards North Korea was coming unstuck. His country's efforts to engage North Korea had been intended to change the North's behaviour, but an increasing number of South Koreans see little to show for it. Mr Roh is coming under pressure to suspend the Kaesong and Kumgang ventures. But he will think hard before doing so, for fear that this would raise tensions further.

Japan is far more willing to get tough. On October 11th it imposed its own extra sanctions, banning North Korean ships from its ports and cutting off all North Korean imports. Before this, it was North Korea's third-largest trading partner.

Much more can be done, the Japanese believe, to stop Mr Kim's flow of cash, notably in China. Mr Kim chiefly makes his money from a shadowy network of enterprises known as Division 39. Some of the group's businesses appear to be legitimate. It is the biggest exporter of ginseng and the pine mushrooms (often picked by prisoners) that are an autumn delicacy in Japan, and it has interests in seafood and metals. But it also engages in drug smuggling, counterfeiting and arms sales. The proceeds from these rackets are spread around the regime, particularly the army, to cement its support for Mr Kim's leadership. This explains why North Korea has reacted so shrilly to America's moves against the North's banking assets in Macau.

Japan has at least declared categorically that North Korea's test will not prompt it to pursue its own nuclear programme. This means that one of China's biggest concerns has, for the moment, abated. China is also doubtless relieved that Mr Bush, in his statement on the test, sounded more anxious about nuclear technology seeping from North Korea (a “grave threat” to America) than he was about the test itself.

But the United States and most regional powers do not yet see eye to eye. Christopher Hill, the chief negotiator on North Korea, said before the test that America was “not going to live with a nuclear North Korea”. North Korea's northern and southern neighbours feel they simply have to.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com SPECIAL
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Proliferation

A regime as rickety as his own

Oct 12th 2006
From The Economist print edition

Kim Jong Il mocks the bargain between the nuclear haves and the have-nots

BY HIS own standard George Bush is failing in his pledge, set out in his state-of-the-union message in 2002, not to allow the world's most dangerous regimes to acquire nuclear weapons. He invaded Iraq but found no nuclear programme; he failed to prevent Iran from rushing ahead with uranium enrichment that may be designed to make atomic bombs; and this week he could not stop North Korea carrying out what it claimed was its first nuclear test.

The actions of Pyongyang, on top of defiance from Tehran, pose the greatest threat to the Nuclear Non-Proliferation Treaty (NPT) since it was signed in 1968. Both countries are (or were) signatories. Experts fear that a nuclear North Korea may cause Japan, South Korea and Taiwan to seek nuclear weapons, while a nuclear Iran might prompt Saudi Arabia, Turkey, Syria and Egypt to follow suit.

In the early 1960s John Kennedy predicted up to 25 nuclear countries within a decade. Today there are nine. To that extent the NPT and other arms-control measures have been successful, yet the treaty is being eroded rapidly. Now that the physics of nuclear weapons is well understood, and precision technology is more readily available, countries can more easily set up a nuclear programme. Around 40 have the ability, in theory, to develop nuclear weapons.

Under the NPT, the declared nuclear-weapon states—the United States, the Soviet Union (now Russia), China, Britain and France—promised to reduce and eventually eliminate their nuclear stockpiles. In return, the rest of the world pledged to use nuclear technology only for peaceful purposes. But the treaty left gaps. Countries such as Israel, India and Pakistan did not sign it, and have been free to develop nuclear weapons. The inspection system to stop cheating by signatories has also proved faulty. The International Atomic Energy Agency did not detect Saddam Hussein's illicit nuclear programme in the 1980s. A system of more intrusive inspections has been created, but countries are under no obligation to subscribe to it.

Inspections are vital, since the NPT allows countries to come close to having an actual bomb. Japan already has a large stock of plutonium from its civil nuclear programme, and could probably develop a bomb within months. In Iran's case, full mastery of the technology to enrich uranium to make nuclear fuel in power stations would give it the ability to produce fissile material for atomic bombs.

Many countries have resisted pressure from America and others to accept further restrictions on their nuclear facilities, accusing the nuclear powers of failing to make progress on disarmament. Besides, American policy can seem self-defeating. The United States has lifted financial sanctions imposed on India and Pakistan after they tested nuclear weapons in 1998, seeing them as vital allies. Earlier this year the Bush administration signed a co-operation deal with India which, if approved by Congress, would legitimise its nuclear military programme. Some new members of the club are more welcome than others.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com SPECIAL
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Correction: Japan's territorial disputes

Oct 12th 2006
From The Economist print edition

A foolish editing error last week led us to misrepresent Japan's territorial disagreements with its neighbours (see article). We meant to say that China disputes Japan's control of the Senkaku/Diaoyutai islands, while Japan disputes South Korea's control of Tokdo/Takeshima. Our apologies. This error has been corrected online.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

America's population

Now we are 300,000,000

Oct 12th 2006 | HOUSTON
From The Economist print edition

America's rising population will solve more problems than it creates

THE Lakewood Church in Houston has a space, complete with cartoon murals, for parents to leave their children while they attend a service. There is room for 5,000 children. Lakewood's size may be unusual—it occupies a refurbished basketball stadium, and Pastor Joel Osteen's televised sermons are watched by 7m people each week—but its focus on the family is not. “I love children because they are so pure,” says Victoria Osteen, Mr Osteen's wife and co-pastor. “For myself, [having children] has been an awesome, wonderful, full life.”

When Europeans hear the words “America”, “religion” and “family values”, they think of brimstone preachers raging against unconventional domestic arrangements. They often forget the more positive role American churches play in nurturing conventional families. Lakewood's ministries, for example, teach married couples how to communicate better and give them practical advice on how to bring up children and put the family finances in order. In such a mobile society people often have nowhere else to turn for friendly counsel. Hillary Clinton once said that “it takes a village to raise a child.” Often in America “the church is the village,” says Stephen Klineberg, a sociologist at Rice University in Houston.

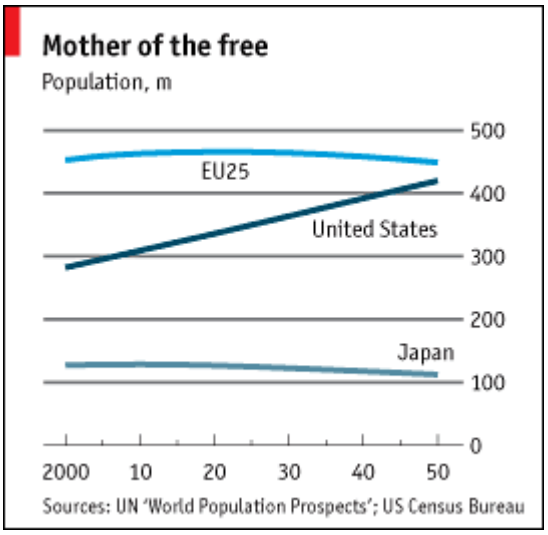
On or around October 17th, according to the Census Bureau's population clock, the number of people in the country will hit 300m, up from 200m in 1967. By as early as 2043, the bureau says, there will be 400m Americans. Such robust growth is unique among rich countries. As America adds 100m people over the next four decades, Japan and the EU are expected to lose almost 15m.

These are only projections, of course. Lifespans will no doubt continue to stretch and immigration rules may change. What is striking, though, is the gulf between the fertility rate in the United States and other rich countries. American women today can expect to have an average of 2.1 children. That is the number needed to keep a population stable, so observers sometimes take it as a given and say that America's population growth is entirely due to immigration. This obscures the point: for every big advanced country besides America and Israel, the alternative to “replacement rate” fertility is a baby bust.

The fertility rate in the EU is 1.47—well below replacement. By 2010, deaths there are expected to start outnumbering births, so from that point immigration will account for more than all its growth. And that average hides countries that have seen an astonishing collapse in the willingness of their citizens to breed. The fertility rate in Italy and Spain is 1.28, which, without immigration, would cause the number

of Spaniards and Italians to halve in 42 years.

Falling birth rates are linked to prosperity. People in very poor countries tend to have lots of babies because they expect some of them to die in infancy, and because they need help in the fields and someone to care for them in their old age. The fertility rate in Niger and Mali, for example, is over seven children per woman.



As countries grow richer and women get educated, they have fewer children and invest more in each one. Whereas peasants in Mali cannot afford not to have kids, many Westerners fret that they cannot afford to have them. University is expensive, and if Mum (or Mom) decides to stay home, the household must forgo the salary she used to earn. Add to this the sudden halt to a life of carefree first-world hedonism, and it is no wonder that birth rates have plummeted in all rich countries.

But much less so in America. Why should this be? Religion plays a role, argues Mr Klineberg. Americans are more devout than Europeans, if church attendance is any guide, and their faith colours their worldview. Don Iloff, a spokesman for Lakewood Church (and Victoria Osteen's brother), agrees. Faith begets hope, he says, and if you have hope for the future, you are more likely to want to bring children into the world.

Polls certainly suggest that Americans are more optimistic than people in most other countries. Philip Morgan, a sociologist at Duke University, and Miles Taylor, a population expert at the University of North Carolina, cite several other possible factors. Birth rates are lower in more patriarchal rich countries, such as Japan and Italy, than in places where the sexes are more equal, such as America and Scandinavia. Perhaps the knowledge that Dad will help with the housework makes women more willing to have children.

America's wide open spaces also make child-rearing more attractive. Bringing up a large family in a tiny Japanese apartment is a struggle, even if you can fold away your bed during the day. The world's lowest fertility rates are in super-crowded Hong Kong (0.95), Macau (1.02) and Singapore (1.06). In America the average family-home has doubled in size in the past half-century, from 1,000 square feet (93 square metres) in 1950 to 2,100 square feet in 2001.

America's coastal areas are fairly densely settled, but families who cannot afford a spacious home with a garden in Connecticut or California can move somewhere cheaper. They often do, one reason why the mean centre of America's population—ie, the point at which an imaginary, flat United States would balance if only the people on it weighed anything—keeps moving south and west. In 1800 it was still near the eastern seaboard, in Maryland. By 2000 it was in Phelps County, Missouri, and heading for Oklahoma.

Houston, we have lift-off

Can America cope with a relentlessly expanding population? A look at Houston suggests it can. The city is one of America's fastest-growing. The population of Harris County, which includes Houston, grew by 21% in the 1990s, to 3.4m. The surrounding counties are booming, too. Since Houston has no zoning laws, developers can build wherever they think there will be demand. Rather than waiting for the city to extend sewers and power lines to outlying areas, they can issue bonds to pay for such services themselves, and pass the cost on to the people who buy the houses they build.

At the Woodlands, a 28,000-acre (11,300 hectares) planned community north of Houston, you can buy a three-bedroom family home on a quiet wooded street for $130,000. By comparison, the median house price in San Francisco is over $700,000. The Woodlands has good schools, 145 miles (235km) of hiking trails, golf courses designed by the three greatest retired golfers in the world, and a cluster of oil and high-tech firms.

It is also safe. “Police salaries are paid by the community, not the county, so we have more of them,” says Roger Galatas, who used to run the Woodlands operating company. The community makes its own rules. Restrictive covenants prevent anyone from uprooting too many trees, or building eyesores. Several houses share each mailbox, so neighbours chat when they pick up the mail.

Houston was 70% white in 1960, but is now a mix: 57% white (of which 42% are Hispanic), 24% black and 6% Asian. “Where you grew up is irrelevant in Houston,” says Tim Cisneros, a local architect whose mother came from Mexico. “Everyone is so busy making money they don't have time to worry about race.” Polls suggest that the picture is not quite so rosy—79% of blacks think blacks are “often” discriminated against in Houston. But 69% of Houstonians think the city's ethnic diversity will become a source of strength. It is easier to deal with a globalising world if your citizens have roots in many countries.

America's future could look something like Houston's present, argues Joel Kotkin, a writer on demography. As the nation's population surges, it will become more ethnically mixed and especially more Hispanic. Houston suggests that that will be just fine. Rapid growth may cause environmental problems, but it will greatly slow the pace at which America ages. Whereas in the EU by 2050 there will be fewer than two adults of working age for every person over 65, the proportion in America will be less scary, at almost three to one. The problems of growth, says Mr Klineberg, are easier to deal with than the problems of decline.

Can the world cope with a relentlessly expanding America? Many non-Americans will shudder at the prospect, but which alternative superpower would they prefer? China? If demography is destiny, they will not have to find out what a Chinese hyperpower looks like: the fertility rate in China is only 1.7, and there are almost no immigrants.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Ballot initiatives

Questions, questions

Oct 12th 2006 | CHICAGO
From The Economist print edition

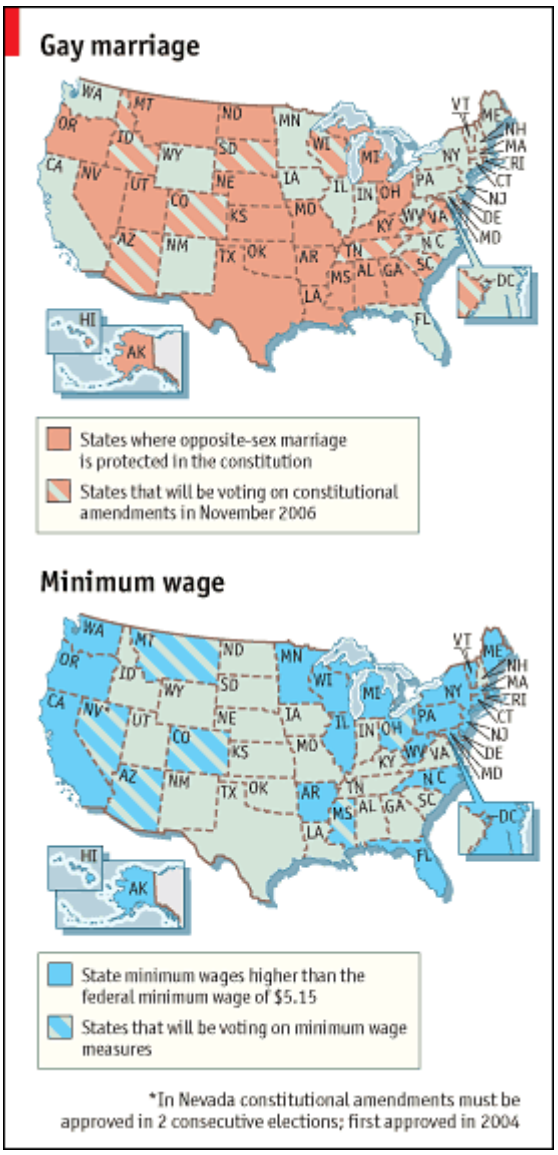
Discontented voters and close races are making this a banner year for ballot measures

ON NOVEMBER 7th voters in Arizona will choose a governor, a senator, eight congressmen and a host of other state and local officials. But those will hardly be the only votes they cast. Their ballots will also allow them to vote on 19 statewide measures that propose new laws or amendments to the state's constitution. One measure, for example, would deny many public services to illegal immigrants, while another would “require that all official actions of the government be conducted in English”. Other ballot measures would raise the minimum wage by $1.60; change the constitution to deny marriage rights to gays explicitly; and bolster private property-rights by narrowing the use of eminent domain. There is even a proposal to give anyone who votes a ticket in a $1m lottery.

If some of these measures affect who turns out at the polls, that could even determine which party's candidate wins a closely contested race. The same is true in other states. Arizona's list is the longest, but it is not alone in crowding lots of questions—including several politically charged “wedge” issues, designed to bring voters of a particular persuasion to the polls—onto this year's ballot. Altogether, 205 statewide measures (to say nothing of lots of local ones) await voters in assorted states this November, according to the National Conference of State Legislatures. Most involve decisions already taken by state legislatures, which they are asking voters to ratify. But 81 of them have been placed on ballots directly by citizen groups. That is the highest number of citizen-driven measures since 1996, when widespread voter disgust triggered a slew of initiatives proposing term limits and restrictions on taxes and spending.

Another wave of discontent is one reason for the resurgence. Now that legislative term limits have been enacted in many states, for example, voters in a few places are turning on judges in a fresh effort to throw rocks at the establishment. A Colorado measure would place retroactive term limits on the state Supreme Court and appellate judges. Several of the state's leading Republicans have said this is a bad idea, but its backers do not heed either party. A South Dakota measure makes judges even more nervous. It would empower a new body of citizen overseers to fine, jail, or slash the pension—even retroactively—of any judge whose conduct the group finds wanting.

Although ballot measures allow some groups to attack the establishment, however, they can just as easily be deployed to serve the goals of America's two main parties. The Republicans have used them in recent years to woo social conservatives. They especially like measures that amend state constitutions to ban gay marriage; one such is widely credited with helping George Bush to win Ohio in 2004. With Republicans struggling to keep their majority in both houses of Congress, voters in another eight states will consider gay-marriage amendments this year (see map).


Gay marriage
States where opposite-sex marriage is protected in the constitution
States that will be voting on constitutional amendments in November 2006
Minimum wage
State minimum wages higher than the federal minimum wage of $5.15
States that will be voting on minimum wage measures
*In Nevada constitutional amendments must be approved in 2 consecutive elections; first approved in 2004

This time, however, the Democrats are fighting back with a wedge issue of their own: the minimum wage. Although America has a federal minimum of $5.15 an hour, states can enact higher ones if they wish. Voters in six states—including a pair of traditional bellwethers, Ohio and Missouri—will choose whether to raise theirs. Missouri will also have a measure promoting stem-cell research in the state. Like the minimum wage, this issue helps the left in two ways. It tends to appeal to voters who lean towards Democrats, perhaps enticing them to turn out; and it may also serve to remind those voters and some independents of another reason why they dislike Mr Bush and his party.

Ballot initiatives do seem to drive extra voters to the polls in mid-term elections, when turnout otherwise drops sharply. Daniel Smith of the University of Florida and Caroline Tolbert of Kent State University have looked at voting patterns from 1980-2002, and estimate that mid-term turnout goes up by an average of 1.7% for each initiative on the ballot. Mr Smith also points out that candidates do not gain just from higher turnout. Having an emotional issue on the ballot can also make it a bigger topic in the campaign, which tends to help the candidate whose backers put it there.

While the left and the Christian right square off on minimum wages and gay marriage, the big wild card this year may be a slew of ballot measures that appeal to libertarians. Eleven states have proposals that protect property rights by narrowing the definition of “public use” under eminent domain. That is a response to an unpopular Supreme Court ruling last year—*Kelo v City of New London*—that upheld a Connecticut town's seizure of plaintiffs' homes so that private groups could build an economic development. The best-acronymed measure is Nevada's People's Initiative to Stop the Taking of Our Land (PISTOL). In four western states, Arizona, California, Idaho and Washington, initiatives would also imitate a 2004 Oregon measure that compensates owners for environmental rules or other restrictions that lower their property's value. Having these measures on the ballot might not help Republicans much. Small-government types might vote for them but choose not to vote for Republican incumbents who have failed to tame spending.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Ingenious punishments

Their object all sublime

Oct 12th 2006 | WASHINGTON, DC
From The Economist print edition

A vogue for shaming wrongdoers

ON SEPTEMBER 30th students at the University of Massachusetts threw a toga party. The cops showed up, uninvited. They charged the host, James Connolly, with under-age drinking, making too much noise, and having a keg without a licence. For punishment, he had to put on his toga again and stand in front of the police station for an hour.

Dan Markel of Florida State University reckons that such “shaming punishments” are on the rise. In 2003 a couple of teenagers who defaced a nativity scene in Ohio had to parade through town with a donkey. “The punishment must fit the crime,” explained the judge, Michael Cicconetti. Several cities have aired the names of men caught soliciting prostitutes on “John TV”. In 2004 a federal appeals court agreed that a mail thief could be made to stand outside a California post office wearing a sandwich board. “I stole mail,” it read. “This is my punishment.” In Virginia, if you fail to pay child support, you may find your car wheel-clamped: pink if you are neglecting a girl, blue for a boy.

Many support shaming punishments. Amitai Etzioni of George Washington University has argued that they are a good way to express communal values. Fines, in contrast, imply that you can buy a clear conscience. And shame seems to be a powerful deterrent. Mr Cicconetti says he sees few repeat offenders. Cheerful Hobbesian types want everyone to know who the bad guys are, so that decent citizens can avoid them.

Others are doubtful. According to Mr Markel, shaming punishments undermine human dignity. He suggests alternative punishments that omit the public-humiliation factor. A landlord who flouts the health code, for example, could be made to stay in one of his own slums. And it is true that there is something unpleasant about the desire to see other people humiliated. Remember the matron who objects to Hester Prynne's scarlet letter: “Why, look you, she may cover it with a brooch, or suchlike heathenish adornment, and so walk the streets as brave as ever!”

But voters appear to be comfortable on the high horse. Ted Poe, a former district judge from Texas, made his reputation by issuing a string of embarrassing sentences. He called this “Poe-tic justice.” Once, he sentenced a man who stole pistols from the Lone Ranger (technically, the actor Clayton Moore) to shovel manure in the Houston police stables. In 2004 Mr Poe was elected to the House of Representatives at his first attempt.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Wal-Mart

High risk, high reward

Oct 12th 2006 | WASHINGTON, DC
From The Economist print edition

Health-care policy may now be decided in Bentonville

Reuters

A frying pan, a pair of sneakers and some amoxycillin please

THESE are tough times for Wal-Mart, America's biggest retailer. Long accused of wrecking small-town America and condemned for the stinginess of its pay, the company has lately come under fire for its meanness over employees' health-care benefits. The charge is arguably unfair: the firm's health coverage, while admittedly less extensive than the average for big companies, is on a par with other retailers'. But bad publicity, coupled with rising costs, has stirred the Bentonville giant to action. Wal-Mart is making changes that should shift the ground in America's health-care debate.

One strategy is to slash the prices of many generic, or out-of-patent, prescription drugs. Wal-Mart recently announced that its Florida stores would sell a list of some 300 generic drugs at $4 for a month's supply; other states will follow. That is above cost but far less than the prices charged by many pharmacy chains, which get profits from fat margins on generics.

Wal-Mart's critics dismiss the move as a publicity stunt. The list of drugs includes only 143 different medicines and excludes many popular generics. True, but short-sighted. Wal-Mart has transformed retailing by using its size to squeeze suppliers and passing the gains on to consumers. It could do the same with drugs. Target, another big retailer, has already announced that it will match the new pricing. A “Wal-Mart effect” in drugs will not solve America's health-costs problem: generics account for only a small share of drug costs, which in turn make up only 10% of overall health spending. But it would help.

The firm's other initiative is more controversial. Wal-Mart is joining the small but fast-growing group of employers who are controlling costs by shifting to health insurance with high deductibles.

From January 1st new Wal-Mart employees will only be offered insurance with very low premiums (as little as $11 a month for an individual) but rather high deductibles (excesses): an individual must pay at least the first $1,000 of annual health-care expenses, and on a family plan, the first $3,000. Unusually, Wal-Mart's plan includes three doctor visits and three prescription drugs before the big deductible kicks in. Since most employees go to the doctor less often than that, the company argues, they will be better off because of the lower premiums. That may be true for the healthy, say critics; sicker workers will see their health costs soar.

This debate, writ large, is the biggest controversy in American health care today. The Bush administration has been pushing high-deductible plans as the best route to controlling health costs and has encouraged them, with tax-breaks for health-saving accounts. The logic is appealing. Higher deductibles encourage consumers to become price-conscious for routine care, while insurance kicks in for catastrophic expenses.

Early evidence suggests these plans do help firms control the cost of health insurance. But critics say that the savings are misleading. They argue that the plans shift costs to sicker workers, discourage preventative care and will anyway do little to control overall health spending, since most of the $2 trillion (a sixth of its entire GDP) that America spends on health care each year goes to people with multiple chronic diseases.

For the moment, relatively few Americans are covered by these “consumer-directed” plans. But they are becoming increasingly popular, especially among firms employing low-skilled workers. And now America's biggest employer has joined the high-deductible trend. That is bound to have an impact.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Miami

Culture club

Oct 12th 2006 | MIAMI
From The Economist print edition

A new persona for the city of Vice

LITTLE by little it has emerged, a huge multimillion-dollar concrete-and-glass gamble on the edge of Miami's waterfront. The inauguration on October 5th of the Carnival Centre for the Performing Arts is being seen as a defining moment for the city: the moment when, perhaps, it can bury the image of “Miami Vice” and cocaine cowboys once and for all.

Over the years Miami has quietly laid down many of the foundations for its new cultural identity. Spending on the arts has doubled since 2000 and stands, this year, at $22m. A host of new galleries and museum projects is springing up. Every December the city now hosts a sister-show to the annual Art Basel, proclaiming it as the most important art fair in America. This year it also hired Terence Riley, former chief curator at the Museum of Modern Art in New York, to take over the Miami Art Museum, which is moving next door to the Carnival Centre. The city's science museum, too, is moving to the bay.

All this may come as a surprise to those more familiar with the city's reputation for rash political decisions and financial crookedness. But there has always been more to Miami than meets the eye. While parts of Miami-Dade County still languish in poverty, it also has a thriving banking and business district and one of the hottest property markets in the country.

Even in the new culture-rich climate, running the Carnival Centre is quite a challenge. Like most performing-arts emporiums, Miami's is built around three local companies performing opera, classical concerts and ballet, as well as the city's all-student New World Symphony academy, directed by Michael Tilson Thomas. The four resident companies, however, will only fill 25% of the performance nights. This leaves a lot of discretion to the centre's own programming staff.

To meet this challenge the centre has formed partnerships with local arts groups, such as the Miami Light Project and the Rhythm Foundation. An eclectic line-up has been put together for the first six months, from Itzhak Perlman to a Colombian heavy rock band. The centre's four halls will also stage Broadway theatre shows, stand-up comedy and contemporary dance. Orchestras are coming from all over the world.

“Miami will be a city that bridges all the imagined borders in the arts,” says Mr Tilson Thomas. The city fathers hope so.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Republican difficulties

How goes Ohio?

Oct 12th 2006 | CLEVELAND, COLUMBUS AND JACKSON
From The Economist print edition

Sleaze and an uncertain economy are hurting incumbents

THE Buckeye State is America in miniature. It has a depressed north-eastern corner around Cleveland and Akron, where jobs lost from steel mills and tyre plants have never been replaced. It has a poor, rural south-east in the foothills of the Appalachians, rich rolling agricultural land around Toledo in the north-west and a prosperous services economy based in Columbus, the fast-expanding state capital. On most metrics, from percentage of Protestants to education spending per child, the state is very close to the national average. So it is not surprising that, when it votes, Ohio mirrors the nation. In the past century it has voted for the winning president on all but two occasions.

If past form continues to hold good, the Republican Party ought to be deeply worried. On November 7th Ohio's Republicans look certain to lose the governor's mansion; an incumbent senator is in grave danger of losing his seat; and as many as three Republican-held seats in the House of Representatives could turn Democratic. Roll that outcome out across the country, and you are looking at a meltdown.

Of course, it may not come to that. As well as general disenchantment with George Bush and the Republican Congress, there are particular reasons why Republicans in Ohio may do worse than elsewhere. Jobs are one: Ohio's unemployment rate, at 5.7%, is a percentage point above the national average. But top of the list is corruption. Ohio's current governor, Robert Taft (who is not running for re-election) was convicted last year for failing to disclose golf outings from lobbyists and sundry small gifts, including a stuffed bear and an autographed football.

In August a Republican congressman, Bob Ney, pulled out of his re-election race after being accused of taking money from Jack Abramoff, a disgraced ex-lobbyist. Last month Mr Ney pleaded guilty. This week, a prominent Republican fund-raiser went on trial for embezzlement in a case involving the state's investment in rare coins. But these cases don't just affect Ohio: they have contributed to nationwide views about Republican sleaze.

The second big problem for Ohio Republicans is their choice for governor to replace Mr Taft. Kenneth Blackwell is regarded even by his allies as a polarising figure. Closely linked to Ohio's vast evangelical churches, he helped lead the campaign in 2004 for Ohio's constitutional amendment to ban gay

marriage. He fought a tough primary battle against a moderate Republican opponent that forced him, rhetorically, well out to the right. And he is trailing the Democrat contender, Ted Strickland, by the astonishing margin of 20 points in some polls.

Mr Strickland is something of a dream candidate: a pro-gun minister endorsed by the National Rifle Association. Republican Party workers and strategists alike concede, gloomily, that their candidate has no chance; a moderate, they reckon, could have won. The ramifications of the race could be very large: the new governor will oversee the 2008 presidential ballot in Ohio. In 2004 the state voted narrowly for Mr Bush, winning him the election, amid a welter of accusations about foul play at the polling stations.

With the gubernatorial race a lost cause, most campaign effort is shifting towards the congressional fights. But, just like President Bush, Mr Blackwell may have malign coat-tails. At any rate, Mike DeWine, the state's junior senator, is facing a very tough battle when things ought to be easy. Despite all the advantages of 12 years of incumbency, Mr DeWine is struggling in the polls, running slightly behind Sherrod Brown, one of the most left-wing members of the House, who has only half as much cash and who, currently representing the north-east, ought to find it hard to break out of the Democrats' heartland.

It is the same story in Ohio's most interesting House races. In Columbus, once safe Republican territory, the incumbent, Deborah Pryce, is running neck-and-neck with Mary Jo Kilroy; the Kilroy campaign, like many others around America, is dredging up as many pictures as it can find of her opponent standing in proximity to the president and harping on about how often she voted with him. In Cincinnati the Democrats think they have a chance of unseating Steve Chabot, now running for his seventh two-year term. But perhaps the most enjoyable race is in Ohio's 18th district, the seat vacated by Mr Ney.

The 18th is an amazing district, measuring 170 miles (275km) from end to end, taking in 16 counties and some of the state's poorest areas as well as charming little county towns like Jackson. The Democratic candidate, Zack Space, is a near-unknown: he currently serves as the law officer for his small hometown, Dover (population: 12,500). His opponent, drafted in after Mr Ney's demise, is Joy Padgett, with many years of experience as a state representative and senator. The 18th is a pretty conservative place: Mr Bush won it by 14 points in 2004. Yet Mr Space is ahead in the polls.

Like most Ohio Democrats, he is running on a fairly populist platform, demanding the scrapping or rewriting of the free-trade agreements that have, he argues, cost Ohio hundreds of thousands of jobs, “sucking the life out of this state”. Since NAFTA came into effect in 1994, he says, the steel mill that used to be Dover's main employer has closed. Its former workers have jobs paying only $6-8 an hour, and “you can't bring up kids on that”. Republicans have had a lock on Ohio since 1990, and they now control all the state's main elected offices and both houses of its legislature. This year, says Mr Space, “is our best chance to take it back.” And so, perhaps, goes the nation.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Lexington

Waiting for the end, boys

Oct 12th 2006
From The Economist print edition

The Foley fallout is getting worse and worse

HANDS up all those who had heard of Mark Foley a month ago. No one? Mr Foley was one of the most obscure members of the Republican majority. He was a moderate in a party dominated by conservatives, and a middle-aged bachelor in a party where a super-fertile wife is part of the job description (Rick Renzi of Arizona has 12 children, all with first names beginning with "R"). But today he is guaranteed a place in the annals of the party—the omega to Newt Gingrich's alpha.

A slew of recent polls show that the Foley scandal has sent the Republicans into a nosedive. A *USA Today*/Gallup poll gives the Democrats a 23% lead among likely voters. That is double the lead that the Republicans enjoyed in the run up to the 1994 Republican revolution, and the biggest Democratic lead since 1978. A *Washington Post*/ABC News poll shows 55% of Americans saying that congressional Democrats deserve to be re-elected, compared with just 39% for the Republicans. Charlie Cook, a veteran Congress-watcher, now lists 25 Republican House seats as toss-ups, seven more than he did before the Foley scandal broke. Stuart Rothenberg, another analyst of repute, is talking of "a blowout of cosmic proportions".

This is doubly dismal news for the Republicans: dismal because the numbers are so bad and dismal because they have spent the past week or so engaged in a concerted effort to limit the damage and fight back (the firmly Republican Fox News even identified Foley as a Democrat from Florida).

Dennis Hastert led the charge—at least when it came to defending Dennis Hastert—and for the moment it looks as if he has succeeded in saving his job as House speaker. A few conservatives—notably the *Washington Times* editorial page—have called for his head. But most Republicans have argued that pulling Mr Hastert down before the mid-term elections would be a disaster. James Dobson, the founder of Focus on the Family, a conservative-values forum, and the most influential figure on the religious right, has lent his support.

For his part Mr Hastert has given the impression of action (which is all he can do, since Mr Foley has resigned). He has accepted full responsibility—"the buck stops here"—and then swiftly limited his responsibility by saying that he had no idea about the obscene instant messages. On October 10th he

gave a press conference, unhappily in front of a graveyard, arguing that nobody in his office did anything wrong but threatening to fire any of them who were involved in a cover-up.

Yet still there is a growing sense that the Republicans will not be able to limit the damage in November. The drip-drip-drip of scandal continues—and is likely to get wetter as the House ethics committee investigates. There are continuing revelations that senior people were warning of Mr Foley's behaviour several years ago. This week, Jim Kolbe, the only openly gay Republican in Congress, said that he told the House official in charge of the page programme about Mr Foley's "creepy" e-mails to a former page as early as 2001. There is also the fact that Mr Foley's homosexuality was an open secret on Capitol Hill. All of this is likely to depress turnout among social conservatives who are already furious about immigration and Washington corruption.

The Republicans seem to be stymied whatever they do. They cannot change the subject to the economy without tripping over the voters' belief that the economy sucks. They cannot change the subject to defence without raising the question of Iraq and the growing rows among leading Republicans over what to do about it (James Baker, secretary of state under George Bush senior and head of a group of wise men known as the Iraq Study Group, all but argued this week that the invasion was a mistake).

The result is that the only debate on the right now is how bad will it be. In public, Republicans say they still have huge strengths. They point out that the ruling party's structural advantages—such as the power of incumbency and the protections of gerrymandering—are bigger than they were in 1994. Their ability to use technology to target voters and get them to the polls is better than the Democrats'. They emphasise the fact that the Democrats need a clean sweep of six Senate seats (and must save an iffy seat in New Jersey) if they are to take over the upper chamber. And they point out that most voters worry about local issues rather than national politics. But in private they admit that they expect to lose between seven and 30 House seats.

Out of the frying pan

All this could conceivably change before November 7th. The electorate is in a volatile mood—only three weeks ago the Republicans' numbers were back on the way up, thanks to cheaper oil and tough talk from the president on terrorism. The Republicans may yet be able to persuade people that a divided government is the last thing they need in a world in which various eccentric rulers are trying to build nuclear bombs. But there is an air of doom about the Republican majority—a bit like, say, the atmosphere among Tories in the months before Tony Blair's 1997 landslide.

But there is one big difference. Mr Blair won, not just because of the Tories' woes, but because he exuded a sense of renewal and purpose. In America, it may be the *fin de siècle* of the Republicans, but the Democrats do not inspire much confidence. Too many of the party hacks in Congress are pre-Clinton types who want to roll back Bush's tax cuts, adopt a lower profile around the world and, above all, take revenge on Mr Bush and his cronies. If they get their way, the result will be not a change in direction but paralysis and political warfare. If the first six years of Mr Bush's presidency have been characterised by unbridled energy in the executive, there is a danger that the last two could see too little of it, with endless inquiries and investigations. The prospect of leaving the world's only superpower distracted and self-obsessed may be the Republicans' only trump card.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Correction: MoveOn.org

Oct 12th 2006
From The Economist print edition

In our article on negative campaigning last week ("The same to you with knobs on", October 5th), we referred to MoveOn.org as a "527" group. Although it used to be a 527, it is now a PAC.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Ecuador's elections

An enigmatic leftist rides into town

Oct 12th 2006 | QUITO
From The Economist print edition

Corbis

Ecuador may fall to an anti-American ally of Venezuela's Hugo Chávez

Get article background

AT RAFAEL CORREA'S campaign rallies, his supporters hold their belts aloft. More than a tribute—*correa* means belt—the gesture salutes the candidate's intention to whip the “mafias” that have misgoverned Ecuador since democracy was restored in 1979. Mr Correa, who calls himself a Christian leftist, is narrowly favoured to win the presidential election, either in the first round on October 15th or in a run-off 42 days later. Not only the mafias are worried.

Although Ecuador has just 13m people and a $40 billion economy the elections—for a new Congress and part of the provincial and municipal legislatures as well as the presidency—are being closely watched abroad. Mr Correa flaunts his friendship with Venezuela's left-wing authoritarian president, Hugo Chávez. After Mr Chávez compared George Bush to the devil Mr Correa wondered whether the devil would take offence. He opposes a free-trade agreement with the United States, even though neighbouring Colombia and Peru have each signed one, and intends to shut the American military base in Manta. He threatens to follow Argentina's example in defaulting on Ecuador's $10 billion foreign debt, the third such default in little more than 20 years. Mr Correa's victory, many fear, would push Ecuador into the club of Latin American countries with governments that revile the United States, erode democracy and use their oil revenues to defy economic gravity.

He is prospering because Ecuador's political and economic system has been so thoroughly discredited. Street protests have toppled three presidents in the past decade, most recently in April 2005, when Lucio Gutiérrez was thrown out. Political parties are seen as little more than fronts for the business interests of their leaders. The courts are regarded as creatures of the same oligarchs, who plunder the budget and state-owned companies such as Petroecuador, the country's biggest oil company. Support for democratic institutions is one of the lowest in Latin America. “We want total change,” says Judith Montenegro, a young pro-Correa activist.

Mr Correa means to deliver it by summoning a constituent assembly “with full powers” to sweep away the “dictatorship of the parties”. He has already made it difficult, should he win, to govern within the traditional political framework. He has fielded no congressional candidates, although the tiny Socialist Party backs him. Congress is thus likely to be dominated by the political parties he intends to destroy. Mr Correa's utopian plan raises two troubling questions. Will the new order be a recognisably democratic

one? And how hard will the old order strike back?

His short political career leaves Ecuadoreans guessing what sort of president he would be. An economist with an American PhD, Mr Correa was last year plucked from obscurity as a professor at a fancy private university to be economy minister under the outgoing president, Alfredo Palacio. As in Venezuela, oil fattens the revenues of Ecuador's government, and Mr Correa showed Mr Chávez's penchant for spending it. He became a popular hero by dismantling a fund meant primarily for paying debt in order to boost social spending and was soon forced out (under pressure from Ecuador's foreign creditors, his defenders allege). His constituent-assembly plan echoes the one Mr Chávez used to consolidate his power and Bolivia's project to “refound” the country.

“Everyone thinks he's Chávez and he's not,” says Juana Ordóñez of Multiplica, an economic consultancy. Certainly, he is more worldly than the Venezuelan strongman or his radical Bolivian counterpart, Evo Morales. Sometimes, he is pragmatic. He opposes Ecuador's use of the dollar as its currency, which has brought low inflation, but does not plan to stop it. The constituent assembly, he suggests, will strengthen democratic institutions rather than undermining them. He wants to “depoliticise the courts”, conduct a “deep reform” of the government bureaucracy and have congressmen elected by district rather than by province, making them more accountable to their electorates. Yet doubts persist. “If developments push his government against the wall he may take anti-democratic measures,” worries Pablo Andrade of Universidad Andina Simón Bolívar.

That may well happen. Congress will resist Mr Correa's call to drown itself in his constitutional deluge. The army, still the final arbiter in Ecuadorean affairs, is likely to take its side. Mr Correa intends to appeal to the people, but they will follow only so far. Unlike Bolivia's political eruptions, which originate from below, Ecuador's are sustained in part by the middle class. Conditions are wretched. Despite years of oil-fuelled growth, more than half the population lives below the poverty line; a similar proportion is underemployed or jobless. Yet Ecuador's unrest is provoked less by deprivation than by anger at a grasping elite. That has fed Mr Correa's support but may also put limits on it. If elected, he may not last long.

His victory is far from certain. Around 30% of voters are still undecided; some are turned off by his radicalism. But the alternatives are unappealing. Two of the main contenders, Álvaro Noboa and Cynthia Viteri, purport to offer liberal visions of free trade and investment. But Mr Noboa, a banana magnate, has run a flagrantly populist campaign. Proclaiming himself “God's messenger”, he distributes T-shirts in poor villages, promises jobs and housing and ministers to the sick with his “Álvaro Noboa Medical Brigade”. Many suspect that his clearest vision is of the welfare of the banana trade. Ms Viteri appears to be the puppet of the de facto boss of her Social Christian Party, León Febres Cordero. Another contender, León Roldós, an uninspiring lawyer, shares Mr Correa's concern for social justice but is not spoiling for a fight with the establishment. Unfortunately, he is said to have the sex appeal of a lamp-post. Still, Mr Correa could lose to an anti-Correa coalition in the second round.

Sex appeal is not Mr Correa's problem. He is admired as much for his youth (he is 43) and his good looks as for his crusading spirit. In Ecuador, however, presidencies have a habit of dying young.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

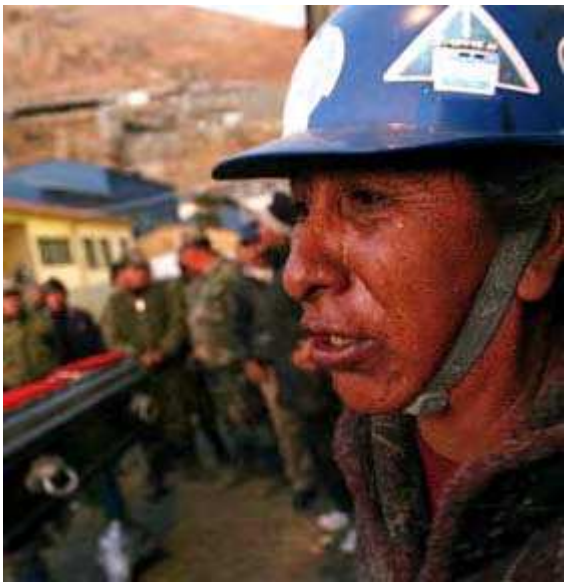
Bolivia

Losing the miners

Oct 12th 2006 | LA PAZ
From The Economist print edition

A bloody setback for Evo Morales

AP



Grieving, and not just over his pay

Get article background

A VIOLENT battle between rival groups of miners at Huanuni in south-west Bolivia, one of the biggest tin mines in the world, has plunged Evo Morales, Bolivia's first indigenous president, into his most serious crisis since coming to power ten months ago. On October 10th, the anniversary of Bolivian democracy passed by without celebration. Instead, it was marked by strikes and demonstrations that brought La Paz, the capital, to a standstill, and an announcement from the independent mining co-operatives that they were breaking their alliance with Mr Morales. “From this moment we have absolutely nothing to do with the government. We remove our support from them.”

Mr Morales has been widely blamed for the confrontation on October 5th-6th that left 16 dead and at least 80 wounded. He has been condemned for allowing the violence to escalate before intervening, and for scurrying off at the weekend to discuss coca eradication in the Chapare region, while Huanuni's families were burying their dead. The police were not sent in until the second day of fighting, when at least 11 people had already been killed. The ten organisations that make up Fencomin, the co-operative miners' union, hold the government responsible for what they describe as “a criminal act”.

Several thousand miners fought with guns and dynamite for two days in Huanuni, where both independent and state-employed miners work. State employees, who earn around $150 a month, complain that the independent miners, paid per kilo of ore extracted, earn more than them, while the co-operatives want the right to work more of the mine. They have already attempted to seize control of mines a dozen times in the past four years, though there have never been any deaths before.

The battle caused an estimated $2m of damage at the mine. Production is likely to be stopped for at least another week, resulting in further losses of around $200,000 a day. Although the miners have now reached a truce, division of the mine is yet to be agreed. In the wake of the violence Mr Morales has sacked both the mining minister, Walter Villaroel, a former head of a mining co-operative, and Antonio

Rebollo, head of the state mining company, COMIBOL. The new mining minister, Guillermo Dalence, now talks darkly of “rebuilding” COMIBOL and of “returning to the Bolivian state the unrestricted use of all natural resources, in this case the mines.” Mr Morales has also hinted at nationalisation, saying that any mining concessions in which there has been no investment “must return to the hands of the Bolivian government”. Further details are to be announced on October 31st.

The president's spokesman has sought to make light of the defection of the co-operatives, one of Mr Morales's most important backers: “It doesn't affect us...The national government does not need allies like this.” But with the president's approval ratings falling from 81% in May to 58% even before the latest violence, the president may soon need all the friends he can get.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Mexico

Chemical reaction

Oct 12th 2006 | COMALCALCO AND VILLAHERMOSA
From The Economist print edition

The end of the line for Andrés Manuel López Obrador?

ANDRÉS GRANIER, candidate of the Institutional Revolutionary Party (PRI) arrives in town. He is greeted by fireworks launched from Comalcalco's central square. Above, they are beautiful, but the booms below trigger car alarms and set babies crying. No one really minds, though, as the rapturous cheers from the crowd affirm. "*Químico*, *Químico*!" (Chemist, Chemist!), they cry. This is not for the magician behind the pyrotechnic enchantment, but for the man likely to become the next governor of Tabasco, home state of Andrés Manuel López Obrador, Mexico's failed presidential candidate, in elections on October 15th.

Before becoming a politician, Mr Granier was indeed a chemist, working in a series of government laboratories, rising in the hierarchy to become head first of the state's service's laboratories, later of the state's water authority. He has long since left experiments and test tubes behind—he was mayor of Villahermosa, Tabasco's capital and biggest city, from 1997 to 2000—but the name has stuck. His opponent in the gubernatorial race, César Raúl Ojeda of the Party of the Democratic Revolution (PRD), has been performing some alchemy of his own—turning what had been his solid lead in the polls this summer into a double-digit deficit.

Mr Ojeda is closely linked to Mr López Obrador, also from the PRD, who won almost 60% of the vote in Tabasco in the presidential election on July 2nd. He has spent the past few weeks at Mr Ojeda's side, trying to revitalise a campaign that flagged during the months of protests instigated by Mr López Obrador against alleged electoral fraud after losing the July poll to Felipe Calderón of the National Action Party (PAN) by just 0.56% of the vote.

Mr Granier, by contrast, although a member of the PRI for over 25 years, is distant from Roberto Madrazo Pintado, another *tabasqueño* and the PRI's failed presidential candidate. Mr Madrazo, a former governor of Tabasco and PRI leader from 2002-05, who trailed far behind both Mr Calderón and Mr López Obrador in the presidential vote, is now "out of politics", says Mr Granier firmly.

Tabasco is one Mexico's most prosperous states and site of much of its plentiful (though possibly declining) oil reserves. Yet both the leading gubernatorial candidates have focused on the lack of resources for the state's poor. Coming from parties whose ideologies are well nigh indistinguishable, it is no surprise that their campaign proposals are also markedly similar; both trumpet the sort of new infrastructure projects that tend to characterise local politics.

Indeed, the only substantive issue between them is how to deal with the PAN. The party is almost non-existent as a political force in the state (its candidate is unlikely to get more than 5% of the vote in Sunday's poll), but Mr Granier promises to work with Mr Calderón, while he is anathema to Mr Ojeda. This accounts for the polarised atmosphere in the campaign, exacerbated by comically biased local newspapers on both sides.

The impact of Sunday's election will be felt well beyond Tabasco. The likely PRD loss will be seen as the last nail in Mr López Obrador's political coffin. Not only would such a defeat on his home turf be a political humiliation for him, but gaining control of the state government could have provided him with a lucrative source of funds for his promised campaign of "civil resistance" against Mr Calderón's victory. He may well have to find a chemist, or alchemist, of his own if he is ever to revive his sagging political fortunes.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Religion in Canada

Coming out

Oct 12th 2006 | OTTAWA
From The Economist print edition

Religion is creeping into Canada's normally strictly secular politics

FOR most of its early history Canada was riven by religious conflict, with the English-speaking Protestant majority battling the mainly French-speaking Catholics. Religion was gradually excluded from public discourse by a combination of political compromise, Western secularism and the need to make immigrants feel welcome. Until recently, you could meet a political or business leader and never know his faith or whether he had one at all. Unlike Americans, Canadians considered faith a strictly private matter.

Not any longer. Religion is now back on centre stage as Stephen Harper, the Conservative prime minister, prepares to make good on a campaign promise to revisit the legalisation of same-sex marriage and hold a free vote on it in the House of Commons. Gay weddings were a divisive issue when the Liberals made them legal in 2005 as a matter of equality. They will be even more so when Mr Harper challenges that law as a matter of faith.

There are rumours, only partly denied by the government, that should he lose the vote Mr Harper will bring in a Defence of Religions Act, ostensibly to protect officials from being forced to perform same-sex marriages against their will, but more likely so as to placate Conservative supporters from the Christian right. Canada's Charter of Rights and Freedoms, along with various provincial laws, already give officials all the protection they need.

Mr Harper has never made a secret of his religious leanings. He is an evangelical Christian, a small but increasingly vocal group with deep roots in the west. In the 2001 national census 75% of Canadians identified themselves as Catholic, Protestant or just Christian, though only around 25% go to church every Sunday. It is difficult to say exactly how many members of the mainstream faiths are evangelicals because their churches are often small and unregistered. Estimates range between 10% and 12% of the population. However, they make up in enthusiasm what they lack in numbers, attending church much more regularly, contributing more in volunteer time and money, and speaking out loudly on matters of faith. But hitherto Mr Harper has kept his own spiritual side largely under wraps, apart from ending his speeches with a fervent “God bless Canada!”

Important government initiatives such as the accountability bill, Senate reform, and the new environmental plan announced this week have no religious overtones. Even smaller ones meant to appeal to the Christian constituency—a slew of crime bills, child-care payments for parents, and the decision to drop a Liberal bill to decriminalise marijuana—may please the godless as much as the god-fearing.

But as politicians discovered the first time round, there is no keeping religion out of the same-sex marriage debate. Parties splintered as some MPs backed the former Liberal government's claim that equality should trump all else, while others sided with Mr Harper, who contends that marriage between a man and a woman is an institution sanctified by faith.

In revisiting the question, Mr Harper launches his first big battle as prime minister with religion at its core. “It's the first time the f-word (faith) has snuck into the discourse,” says Andrew Grenville of Ipsos-Reid, a pollster. Mr Harper can count on stronger support this time from the plethora of Christian groups that have become more active politically. But Mr Grenville thinks raising the issue now is a rare misstep by the normally sure-footed prime minister. Public support for evangelical Christian leaders has plummeted, he says, dragged down by the unpopularity of the ostentatiously religious American president, George Bush. Every public endorsement Mr Bush makes of his friend “Steve” underscores that negative association.

The Liberals, meanwhile, are publicly outraged but privately pleased at the chance to paint the Tories as

intolerant zealots seeking to impose right-wing values on Canadians. Making a fuss about religion now may even help voters forget the corruption scandal that forced the party from power. For years, the Liberals have been accusing Mr Harper of having a hidden agenda. At last they think they have the evidence.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

India's Special Economic Zones

Cash cows

Oct 12th 2006 | DELHI
From The Economist print edition

Reuters

They worked in China. But will India's zones boost investment, or just divert it?

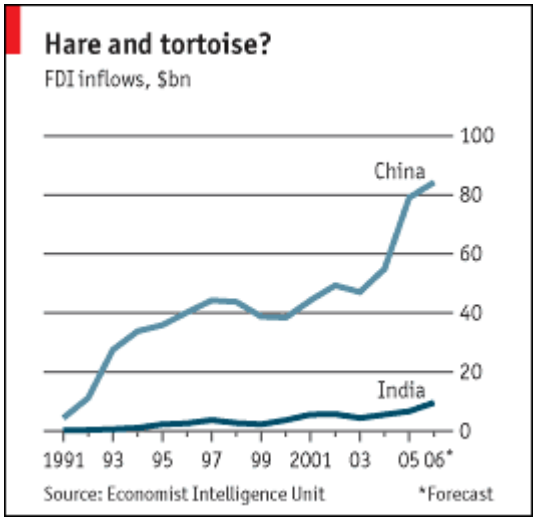
IT RESEMBLES the rows that have dogged every step taken by the two-year-old government led by Manmohan Singh, India's prime minister. The government's economic reformists, of whom he himself is the most distinguished, promote a liberalising measure that will help boost investment, fix India's lousy infrastructure and create jobs. They find themselves howled down by a coalition of their Communist allies, leftists in Mr Singh's own Congress party and other activists, who accuse them of being anti-poor. The latest confrontation, however, over the development of Special Economic Zones (SEZs), is different. This time the criticism comes not just from the usual suspects but also from some of the reformists, many economists and even some leading industrialists.

The idea is simple enough: SEZs are enclaves with streamlined procedures, tax breaks and good infrastructure that will lure investors in export-oriented industries. Many developing countries, including China, have used them successfully. They are not even new in India. In 2000 eight existing “export processing zones”, the first of which dated from 1965, were converted into SEZs. But in February India's Parliament finalised a new SEZ law, offering even more enticements. There has since been the bureaucratic equivalent of a gold rush. Companies, including most of India's most famous firms, have filed more than 400 applications to set up SEZs, and 212 have been approved.

Banging the drum for India as an investment destination in London this week, Mr Singh and his commerce minister, Kamal Nath, were able to point to the SEZs as evidence of India's new openness. Mr Nath's ministry hopes they will attract more than $5 billion in foreign direct investment by the end of 2007—a huge amount for India by historic standards (see chart). They are also intended to fix India's “infrastructure deficit” of pot-holed roads, clogged ports and intermittent power. The government hopes that with the incentives available in SEZs, the private sector will make a big contribution towards the $320 billion-worth of investment in infrastructure that India is looking for in the next five years.

That is a laudable enough aim. But the SEZs are under fire on many fronts. Politically, the most sensitive charge, and the one that will probably lead to some change in policy, is that farmers are being forced to sell their land and lose their occupations, and that state governments and developers are profiteering. Sonia Gandhi, Congress's leader, says that agricultural land normally should not be used for SEZs. But under India's constitution land

is an issue for state governments, not the centre.



Many of the SEZs mooted may simply be property deals. Developers hope to acquire cheap land, put in a minimum of infrastructure and sell it. Only 35% of the land area of a SEZ must be used for production. Even the central bank, the Reserve Bank, seems to have suspicions, classifying loans to SEZs as "real-estate" lending, which makes them relatively expensive.

Even some investors planning to manufacture in a SEZ think the terms too generous. They include a five-year holiday on profits tax, and exemption from import and excise duties and from some licensing requirements. Rahul Bajaj, chairman of Bajaj Auto, a maker of two- and three-wheeled vehicles, argues that "any rational businessman would conclude he is better off being in a SEZ." Since, to qualify for the benefits, a manufacturer in a SEZ need only be a net earner of foreign exchange over a five-year period, rather than exclusively an exporter, firms such as his can use a SEZ to supply some of their domestic market.

The fear of many economists—including some in the Ministry of Finance—is that rather than promoting new business, the SEZs will merely attract investment that would have been made anyway. Instead of finding fresh sources of money for its infrastructure, India would thereby have made things worse by depriving itself of tax revenue. Raghuram Rajan, chief economist at the IMF, expresses concern that India, with its big fiscal deficit, can ill afford this loss. Earlier this year the finance ministry put it at 1,750 billion rupees ($38.3 billion) by 2011. The commerce ministry counters with its own forecast that the SEZs will generate additional revenues of 440 billion rupees.

One of the big differences between India's SEZs and China's is in size. Although Reliance Industries, India's biggest private-sector company, is planning enormous, town-sized, SEZs near Mumbai and in Haryana, near Delhi, most of the others are tiny. The minimum area for a "multi-product" SEZ is 1,000 hectares (3.9 square miles), for a "product-specific" zone, it is 100 hectares, and for information technology, biotechnology and jewellery, just ten hectares. By comparison, Shenzhen, biggest and most famous of China's original SEZs, covers 126 square miles. That scale was a huge factor in its initial success— along with the presence, just over the border in Hong Kong, of labour-intensive manufacturers wanting to lower their costs. Enjoying neither of these advantages, India's smaller SEZs may do more for their promoters than for India.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

The Philippines

A troublesome priest

Oct 12th 2006 | MANILA
From The Economist print edition

EPA

Another dissident is murdered. Is the government to blame?

A WHITE ribbon, draped across the lid of Bishop Alberto Ramento's open coffin, carried the words: “bishop of the poor, workers and peasants”. His corpse, embalmed and dressed in red robes, lay exposed at a cathedral in Manila this week to the many tearful mourners from the bishop's Philippine Independent Church. The multiple stab wounds in it were hidden. But the cleric's murder last week, as he slept in Tarlac, north of the Philippine capital, has aroused worries around the world. Rowan Williams, the Archbishop of Canterbury, has said he is “gravely concerned” by suggestions that the killing was politically motivated.

There are reasons to suspect that it was. The dead bishop, whose breakaway Catholic church has 1.5m followers, was a campaigner for workers striking at a local plantation. He was also a noisy critic of the Philippine security forces, who are suspected of involvement in a spate of recent killings. The police say Bishop Ramento was the victim of a violent robbery, and they have arrested four alleged culprits.

In the Philippines, those who criticise or ask awkward questions about powerful people are quite likely to be killed. Bishop Ramento's name has now been added to a list of several hundred outspoken priests, activists, journalists and other dissidents murdered since President Gloria Macapagal Arroyo came to office in 2001.

Opponents of Mrs Arroyo claim that there is a conspiracy at the top levels of the government and army to eliminate her critics. This may be an exaggeration. But a failure to investigate the killings properly has helped create an air of impunity: soldiers and policemen, rogue or otherwise, appear to be rubbing out those they dislike. Popular targets include anyone suspected of involvement in a long-running communist insurgency; Mrs Arroyo recently broke off talks with its leaders, and declared war against them. An internal army document, “Knowing Your Enemy”, includes the journalists' union and even Roman Catholic bishops in that category.

In August Mrs Arroyo gave a specially created police task-force ten weeks to solve at least ten of the killings, a deadline that expired this week. The police say they have made arrests in 21 cases. As usual, they say the communist New People's Army (NPA) and its political wing were mostly to blame. The NPA has indeed killed those it suspects of collaborating with the security forces. But the task-force also acknowledges that government soldiers are implicated in some killings.

The sceptical reaction to Mrs Arroyo's creation of this task-force prompted her to set up an inquiry commission, led by José Melo, a retired Supreme Court judge. This too has been rejected by left-wing opposition parties and human-rights groups as a whitewash, since it contains no one from the opposition. Partly for fear of reprisals, and partly because they are suspicious about the commission's motives, the victims' families are refusing to testify. The murdered bishop's son, Aldos Ramento, says there is no point in talking to a commission set up by the very people he blames for his father's death. But, shortly after meeting American diplomats on October 10th, Mr Melo said that the international attention his commission is attracting would at least force the government to try to prevent further killings.

The commission would also be useful if it produced an authoritative list of suspected political murders. The police task-force's report lists 110 such deaths since 2001. Amnesty International reckons there were around 240, while Karapatan, a left-wing human-rights group to which Bishop Ramento belonged, says 700. Even without public testimony from the victims' relatives, it should be possible to eliminate cases in which there is credible evidence that ordinary crime or local feuds were to blame.

Such a list could be used in the case against General Jovito Palparan, a recently retired army chief nicknamed “the Butcher” by left-wing groups. They argue that mysterious deaths of opposition figures always occurred in districts where the general was in charge. In his testimony to the Melo commission, Mr Palparan denied organising death squads. But Rogelio Vinluan, a commission member, said the general had given no convincing answer when asked why he had not investigated soldiers under his command implicated in these killings.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD ASIA

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

South-East Asia

Stuck in a haze

Oct 12th 2006 | BANGKOK
From The Economist print edition

Will the neighbours ever dare to penalise the polluters?

ENVIRONMENT ministers from South-East Asia were due to hold an emergency meeting in Pekanbaru, in Indonesia, on October 13th to discuss the choking haze that has blanketed much of the region in recent days. The smog arrives around this time every year, as loggers and farmers on Indonesia's island of Sumatra and the Indonesian part of Borneo take advantage of the dry season to clear land by burning trees and scrub. This year the smog is the worst since 1997 and 1998, when tens of thousands of people were hospitalised. By some estimates, the cost to the region, mostly in health care and blighted tourism, was $9 billion.

This year's haze has forced the closure of schools and airports in parts of Indonesia. Hospitals in Singapore report a rise in respiratory illness. Malaysia's government has advised people to stay indoors and the youth wing of the country's ruling United Malays National Organisation has staged protests outside the Indonesian embassy in Kuala Lumpur. Visibility in the Malacca Strait between Indonesia, Malaysia and Singapore—one of the world's busiest shipping lanes—has been greatly reduced. The smog has even reached southern Thailand, where face-masks have been distributed to the public in one province.

For centuries, the forest dwellers of Sumatra and Borneo have been slashing and burning to clear land to grow crops. But a sharp rise in the islands' population, and the arrival of logging and plantation firms, have made the situation much worse in recent decades. As a result, Indonesia's government has made it illegal to clear land in this way. But, to the annoyance of its neighbours, it has made little progress in preventing the fires or prosecuting those responsible for them.

The country's forestry minister admitted this week that the government was having little success in dousing the flames. Its latest attempts have included trying to precipitate the rainy season by seeding clouds. But even heavy downpours might not stop some of the fires, which can continue smouldering under the surface in dry, peaty soil.

The terrible hazes of 1997 and 1998 prompted the Association of South-East Asian Nations (ASEAN) to seek ways of co-operating to stop the smog. In 2002 they signed an agreement on “transboundary haze pollution”, under which any country stricken by serious fires could call on its neighbours for help. Indonesia, the main culprit, has failed to ratify the agreement. But on October 12th, a spokesman for President Susilo Bambang Yudhoyono said that it would soon do so. But even if it does ratify, the agreement makes clear that countries are under no obligation to accept their neighbours' offers of assistance. So it might achieve little.

All ASEAN members, not just Indonesia, zealously guard against the slightest perceived threat to their sovereignty. Thus they are reluctant to express more than mild criticism of the others' misdeeds, for fear of being criticised themselves. Unless ASEAN is prepared to impose sanctions on errant members, as the European Union can on its rule-breakers, South-East Asia may be forever stuck in a haze.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Kazakhstan

An apple a day...

Oct 12th 2006 | ALMATY
From The Economist print edition

Oil wealth can fund better health care

Reuters

Safer, maybe, outside

FALLING ill in Kazakhstan is often a dreadful experience, as your correspondent can attest. She once had some blood taken in a hospital in Almaty, the country's biggest city, with a razor blade. The hospital's nurses laughed when she complained about this treatment. After all, they said, that is how they had been doing the procedure since Soviet times. The razor blade did at least seem to be clean.

This was not uncommon in a country whose impressive recent growth, driven by soaring oil production, has done little to improve its moribund health-care system. Even Kazakhs rich enough to turn to the few private clinics are not protected if, say, they suffer a heart attack and need urgent transport. Ambulances are hideously slow to arrive and, when they do, they tend to lack basic equipment, like stretchers.

There is more grievous evidence of the disastrous state of Kazakhstan's health-care system: the recent infection with HIV of 76 children under the age of five (and eight of their mothers) in hospitals in Shymkent, in southern Kazakhstan, from transfusions of contaminated blood or by unclean syringes. Because of this, the minister of health and the local governor were sacked last month by Nursultan Nazarbayev, the country's president. He is personally leading an investigation into the scandal.

As that might suggest, the government recognises that it must improve the health-care system. There is scarcely a family in Kazakhstan that does not have its own horror tale: of one of its members receiving bad or inappropriate treatment; or of the bribes that medical staff, who are all grossly underpaid, routinely demand.

Two years ago the government launched an ambitious programme of reforms, and declared that spending on health care would be increased to 4% of GDP by 2010. The problem lies in implementing the promised reforms, and ensuring that the increased funds are not redirected—including into the pockets of corrupt officials. Improving medical standards significantly will take more than lots of fancy new equipment, necessary though that is. According to one expert, it will take “basically a generation” of new doctors. Call it a decade then, or longer.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Somalia

Islamists half-ready for holy war

Oct 12th 2006 | NAIROBI
From The Economist print edition

Reuters

A look at Somalia's Islamist conquerors: who they are and what they want

Get article background

ISLAMIST control of Somalia, which has been spreading fast but more or less peacefully, was this week checked. The check may be temporary. But with the reported arrival of hundreds of Ethiopian troops in support of the country's UN-recognised but enfeebled transitional government, the scene is disturbingly warlike.

The Islamists, or the Council of Islamic Courts, control most of central and southern Somalia, with the transitional government penned up in the dusty upcountry town of Baidoa and a few straggling settlements along the Ethiopian border (see map). Over the past few weeks the Islamist militias have captured the southern port of Kismayo and several towns near the Kenyan border. Parliamentarians and others have been drifting from Baidoa to Mogadishu, the capital, where they are welcomed by the Islamists. Last week the regime gathered in Mogadishu for the proud opening of a Supreme Islamic Court. The Islamists' aim of imposing Islamic order on one of the world's most anarchic states seemed within sight.

Then on October 9th transitional government troops, with Ethiopian help, recaptured Burhakaba, a strategic town on the Baidoa-Mogadishu road. Ethiopia strongly denies that its troops were involved, just as it continues, unconvincingly, to deny that any of its soldiers are inside Somalia. But locals affirm that Ethiopian as well as Somali troops forced an Islamist retreat from the hilltop town.

The Ethiopians soon withdrew, perhaps to positions in the desert. But the reaction from the Islamists in Mogadishu was immediate and fierce. Even the most moderate among them, usually dressed pacifically in simple robes, donned combat fatigues. Brandishing AK-47s, they declared holy war on Ethiopia. People were told to “await orders”. A force was to be raised to turn back the Ethiopians. There was much talk of martyrdom.

The Ethiopians and Somalis last fought a war in 1977 (though Ethiopia has repeatedly sent troops into Somalia over the past decade; in 1997 it smashed an Islamist group that had threatened to take over). In 1977 the two battled conventionally, with tanks given to both sides by the Soviet Union, and the Somalis managed to reach the walled city of Harer, a centre for Islam in Ethiopia, before being turned back. This time, if war does break out, it will be nothing like that. The Islamists, untrained and ill-disciplined with mostly small arms, are no match for one of Africa's biggest and best-armed forces.

The greater likelihood is that in a war the Islamists would fight asymmetrically, with guerrilla tactics. They are fired up, but the exposed desert scrub of Somalia is not suited to a long guerrilla campaign. Terrorist strikes inside Ethiopia are not unlikely, though, so far at least, Ethiopian claims that bomb attacks in Addis Ababa are the work of Somali Islamists should not necessarily be taken at face value.

Behind the talk of war—and speculation about a new jihadist front—much remains unanswered. Who are the Somali Islamists and what do they want? Though often compared to Afghanistan's Taliban, the comparison quickly breaks down. The two countries are similar in that they are war-ravaged, packed with guns and with considerable potential for hosting terrorist training camps. But the Taliban began as a Pushtun movement, rural and primitive, supported from neighbouring Pakistan, which then headed to Kabul. The Islamists, although far from sophisticated, are a homegrown outfit that began in the slums of Mogadishu and spread to rural areas.

More tolerant than the Taliban

The differences continue. The Islamists are a coalition of *sharia* courts (hence their official name). Each court represents a district, often along sub-clan lines. Most follow Somalia's traditionally tolerant Sufi-infused brand of Islam. Only a very few of the courts seem to have terrorist leanings. Over the past years, as the courts strove to overcome the Mogadishu warlords, they developed militias, some of which have been pooled into a centrally commanded force.

Life in Mogadishu is improving. There are fewer roadblocks. The port and airport have reopened. Prices in the markets have dropped. The streets are being cleaned. Divided neighbourhoods are being knitted back together. There has even been an attempt to limit the environmentally devastating charcoal trade, which previously enriched unscrupulous warlords. Kidnappings and murder have declined. Public executions

have been few, at least so far. Loonier sentences have generally been overturned by the Islamist leadership. And school attendance is rising, particularly among girls. Which all goes to suggest that the Islamists may indeed be intent on bringing peace and prosperity to a country desperately in need of both.

But there is bad news too. The Islamist leadership seems to have little control over the wilder jihadist groups, and is itself hardening on human rights. Foreign aid agencies say that the Islamists now insist on full information on who they meet and why. And there has been no progress on solving the murder of Martin Adler, a Swedish journalist, or of Sister Leonella, an Italian nun gunned down outside the Mogadishu hospital where she worked. Senior Islamists, including the leading moderate, Sheikh Sharif Ahmed, insist that the killers will be brought to justice and punished. But the activities of the jihadists make it hard to catch them.

By some accounts even the leading hardliner, Sheikh Hassan Dahir Aweys, who is on American and UN terror lists but who is a vital part of any deal with the transitional government, now says privately that he cannot control the most radical factions. Mogadishu may be getting safer for Somalis, but it remains a death trap for foreigners. Some senior Islamists now tell journalists and other foreigners not to visit, saying that the jihadists have orders (from whom is unclear) to kill “whites” in Mogadishu.

The most violent known jihadist group is headed by Aden Hashi Farah Ayro, a hitman who may have trained in al-Qaeda camps in Afghanistan and is implicated in the murders of foreign aid workers and Somali peace campaigners. He belongs to the same sub-clan as Mr Aweys and follows a similar fundamentalist interpretation of Wahhabi Islam. Mr Aweys has called Mr Ayro “a good man”, and helped to put him in charge of the *shabbab*, a military youth wing, but is now said to be not so sure.

Mr Aweys, a fervent nationalist, was decorated for bravery as a Somali army colonel in the 1977 war. He wants an Islamic emirate of Somalia, taking in the mainly Somali parts of Ethiopia and Kenya. The failure of the Somali forces at Harer (and betrayal by the Soviet Union, which dropped Somalia in favour of Ethiopia) is said to weigh heavily on him. Mr Ayro's goals seem more those of an Islamist revolutionary intent on luring Ethiopia, an ancient Christian civilisation, into a full-blooded fight with a new mujahideen.

There are shadier characters behind Mr Ayro, or perhaps pulling his strings, of whom even less is known. They look with admiration to Osama bin Laden and are united beyond clan lines, a rarity in Somalia. Some American sources believe the jihadists may be hiding three al-Qaeda suspects wanted in connection with the 1998 bombing of the American embassies in Nairobi and Dar es Salaam, and with attacks in Mombasa in 2002.

Rumours of training camps outside Mogadishu abound. Most of these are mainstream: young gunmen of defeated warlords, previously addled on qat, the local narcotic, having their rough edges smoothed. But there may also be terrorist training going on. There is evidence of foreign fighters joining the jihadists in Mogadishu (such foreigners are fine, say the Islamists, because they are holy warriors). A bigger concern is that the Somali struggle will give birth to potent terrorist cells, with trained and disciplined jihadists infiltrating Somali communities in America, Canada and Europe.

If all this were not enough, famine is a dreadful possibility. The Food and Agriculture Organisation estimates that if the rains fail later in the year, some 3.6m Somalis, or about a third of the country, will be in need of international assistance. The situation is potentially catastrophic. It is troubling, even if the worst is avoided.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Iraq

Divisa in partes tres

Oct 12th 2006 | CAIRO
From The Economist print edition

But dividing Iraq into three parts may be more tempting than realistic

Get article background

THREE years ago, just after the American-led invasion of Iraq, an American sergeant based in the northern city of Kirkuk, then the main focus of ethnic and sectarian competition, offered your correspondent his own interpretation of what was going on. “You know what all this is about? Undoing what you British did at the end of World War I.” He was referring to the peace settlements that followed the collapse of the Ottoman empire, when the British took control of the former provinces of Baghdad, Basra and Mosul and proceeded to lump them together into a single unified state, with a Sunni monarchy in charge. There has been ethnic and sectarian-based conflict ever since.

Seldom has the violence been worse than it is now. Over a 24-hour period this week 60 bound, tortured and murdered bodies were found scattered across Baghdad. Iraq's ministry for migration reports that sectarian killing has caused over 300,000 Sunnis and Shias to flee from one part of the country to another. On top of this comes the worst figure of all: the huge estimate of total deaths by an American-Iraqi medical team (see article).

AFP

Would partition get her out of her tent?

Time, some have suggested, to go back to the drawing board and think about partitioning the country into a Kurdish north, a Sunni centre and a Shia south. The idea was floated in America during the summer by Senator Joseph Biden, though his proposal, like most partition schemes, falls short of creating three separate states. Iraq would remain one country but with a radical form of federalism that divides it into three autonomous regions, with the central government in charge of defence and the distribution of oil revenues.

At first glance, partition has much to recommend it. Iraq is already divided, politically and demographically, into three distinct ethnic and sectarian blocks. Partition would formalise what is fast happening on the ground, allowing the Americans to extract themselves from the task of trying to keep Iraqis from killing each other. Sunni and Shia politicians bitterly contest control of key posts in government and the security forces, while their militias clash over control of territory. In theory, a partitioned Iraq would allow each group to set up its own mini-government and to police its own affairs, removing the incentive for sectarian violence.

Iraq's constitution already allows for autonomous federal regions along the lines of the Kurds' northern self-rule zone. A clear majority of Kurds imply that they would like, at some future date, to secede altogether. Apart from the Kurds, however, few groups are prepared publicly to advocate outright partition, although some, such as the Supreme Council for Islamic Revolution in Iraq (SCIRI), a Shia party, advocate a southern federal region.

Privately, quite a few others think partition a good idea. Many Shias are convinced that the Sunnis will never cease from trying to regain control of the central government. Only by cutting the Sunnis loose, they argue, can peace be restored. Some of the Shia refugees, who have fled Sunni areas and are now living in camps in the south or outside the country, hope that partition will allow them to be permanently resettled, possibly in homes vacated by Sunnis fleeing the other way.

But any attempt to move towards partition would meet fierce resistance. Sunnis, clearly, would oppose any settlement that left them isolated in their oil-poor heartland. The Sunnis, however, are not alone: many Shias, including the radical Sadrist movement, are ideologically committed to Iraqi unity. Sunni and Sadrist opposition was enough to delay a motion presented by SCIRI last month that would have paved the way for the creation of a southern federal region.

Determined opposition would also come from outside. Iraq's Arab neighbours would be fiercely against any division of the country, both on principle and to avoid having an Iranian-dominated Shia state on their doorstep. Turkey, for its part, objects vigorously to the notion of an independent Kurdistan.

Nor is there any guarantee that partition would reduce the violence, at least in the short term. Probably hundreds of thousands of Baghdad residents still live in mixed Sunni-Shia neighbourhoods. If partition was on the cards, it would disastrously encourage ethnic cleansing: sectarian militias would set about creating facts on the ground prior to any drawing of new borders.

In the longer term, creating new sovereign entities could simply transform Iraq from a single failed state to multiple failed statelets, each of which might be used by radical groups to plot attacks on the other. In 2004 the Americans turned over control of Fallujah, a Sunni hot spot west of Baghdad, to locally-recruited security forces—only to see al-Qaeda affiliates take control and use the town as a base for kidnapping and car-bomb manufacture.

Some Shia analysts believe that independence could result in a series of mini-civil wars in the south between the various militias. Iraq may be too fragmented to function as a single united entity. The trouble is that it is also too fragmented to be neatly divided into three.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The human cost of war in Iraq

Calculating casualties

Oct 12th 2006
From The Economist print edition

A statistical study claims that many more Iraqis have died than was thought

COUNTING exactly how many people have died as a consequence of war is something of a dark art. This is particularly so in Iraq, where various approaches—including hospital death data, mortuary tallies and media reports—produce different results. A study based on statistical techniques by researchers at Johns Hopkins Bloomberg School of Public Health, in Baltimore, has concluded that many more people have died than revealed by these other methods. It claims that an extra 2.5% of the Iraqi population has died since the country was invaded in March 2003, mostly as a result of violence.

The study, published in the *Lancet*, is based on random sampling. Selecting small numbers of people at random allows statisticians to say something about the whole population. As there is no reliable census data in Iraq, truly random selection is impossible because the list from which this would take place is incomplete. So the researchers used a technique that is called clustering.

Clustering works by picking out neighbourhoods at random and then surveying all the people living in them. Gilbert Burnham and his colleagues gathered information on deaths from 47 neighbourhoods, each containing almost 40 households.

The survey teams—two male and two female medical doctors fluent in Arabic and English—asked people living in these households whether anyone had died since January 1st 2002 and, if so, what had caused the death. They also asked to see death certificates—and 92% of the reported deaths were certified.

The researchers then compared the death rate after the invasion with that before the fall of Saddam Hussein. They found that it went from 5.5 per 1,000 people a year to 13.3 per 1,000 people a year. They estimate that 650,000 more people have died since the start of the war than would have been expected had the war never begun.

Data from individuals within a cluster are highly correlated. As a result, that 650,000 lies near the middle of a wide range of possibilities. The researchers say that between 390,000 and 943,000 more people have died than would otherwise have been expected. Previous counts have suggested a much lower toll (although earlier work by the same researchers found a high death rate). This, with the wide range, raises suspicions: George Bush quickly dismissed the findings. But there is no mathematical reason why the true figure should be closer to one extreme than the other.

There are other reasons to be cautious. The violence in parts of the country make it perilous for researchers to function. Armed militias may also interfere. But concern that the number of deaths were exaggerated should be partly allayed by the death certificates. At the very least, the study represents a statistically valid attempt to calculate the dreadful things that have happened, and continue to happen.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Gaza

One shrimp at a time

Oct 12th 2006 | KARNI CROSSING
From The Economist print edition

A blocked border crossing

"YOU can't manage a border crossing unilaterally," says Yoni Dotan, the Israeli director of the Karni crossing on the Israeli-Gazan border. The Palestinians feel that Israel does just that. Between narrow lanes of concrete blocks, put there after Palestinian militants drove a car bomb up to the border wall two years ago and killed six Israelis, a forklift loads pallets of seafood onto conveyor belts, which feed them through the wall into giant X-ray scanners. As the Gazan exporter watches, the invisible Israeli operator shifts the belt backwards, and a pallet of jumbo shrimps falls off the end, spilling them into the dust. The forklift operator—the only one allowed into the lane under Israeli security rules—sighs, bends down and begins shovelling shrimps and dirt back into the boxes.

AFP

Tomatoes that didn't survive the delay

The problem is that everything is interconnected. The shrimps should be in sealed containers, says Mr Dotan, because leaking fluids can damage the scanners. But the exporter, who cannot afford a refrigerated truck, has to keep his produce fresh in the heat as it waits to be scanned, so he leaves the boxes open and stands at the ready with bags of crushed ice—itself hard enough to get since Israel destroyed Gaza's power plant in June.

The exporter risks losing the whole stock because of Karni's erratic opening hours, which are partly because Mr Dotan will not open the gates unless Palestinian security men show up, and they are sometimes on strike and sometimes lack even the bus fare to get to work, because the Hamas-run Palestinian Authority (PA) is not paying them, because Israel and the world have suspended funds to the PA, because Hamas will not recognise Israel, and so on into ancient history.

Karni handles most of the imported goods and humanitarian supplies that keep Gaza running, and, most crucially for its struggling farmers and businesses, their exports to Israel, the West Bank and the rest of the world. As part of an accord last November, Israel and the PA agreed to raise the export rate through Karni to 150 truckloads a day by the end of 2005 and to 400 by the end of 2006. Yet at the height of last winter's harvest season the rate reached only 70, and since Hamas took power in March, the average has been just seven. On over 120 working days this year, Karni has been closed for exports.

Walid Abu Shouqa, head of security on the Palestinian side, complains that when the Israeli army closes Karni, it never gives him a reason. (Mr Dotan says he doesn't always learn it either.) Many of the closures happened when Israel made the PA dig in search of suspected sabotage tunnels under the crossing; only after eight months was such a tunnel indeed found.

Army sources say they close the crossing only when they suspect a risk to the lives of the workers there. But there are plenty of false alarms, and the lack of transparency fuels Palestinian suspicions that some of the closures are political—especially since *Haaretz*, an Israeli newspaper, published minutes of a defence ministry meeting suggesting that the Rafah crossing between Gaza and Egypt was being kept closed to put pressure on Gazans. Another reason for distrust is that whereas goods from the West Bank used to account for 20% of the imports going through Karni to Gaza, the proportion dropped to 5% over the summer, suggesting that Israeli goods were getting priority.

Part of the problem, said a World Bank report last year, is also structural: the security burden, and hence the delays, are concentrated on the wall between the two sides. Keith Dayton, an American general in charge of a project to reform the Palestinian security forces, wants to create a secure zone on the Palestinian side, with international monitors and troops from a beefed-up Palestinian presidential guard. Israeli officials are cautiously welcoming. Condoleezza Rice, America's secretary of state, who helped broker the November agreement, is pushing for at least this bit of it to work. In the grand scheme of things, it is unambitious; but when the peace process is stalled, perhaps the only way forward is one shrimp at a time.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

South Africa

Positive dating

Oct 12th 2006 | JOHANNESBURG
From The Economist print edition

HIV sufferers find love online

DATING in South Africa has taken a more positive slant. For the past few years, people have been able to hook up through the Positive Connection, a website offering dating services for HIV sufferers. The service is the brainchild of Ben Sassman, a salesman living in Johannesburg. A few years ago, two of his friends told him they were HIV positive and that they had trouble dating. When they revealed their status, women invariably fled. Mr Sassman suggested online dating, but realised that existing services do not help those with HIV. So he launched www.thepositiveconnection.co.za in 2003.

There are an estimated 5.5m South Africans—about one in five adults—living with HIV, one of the highest numbers in the world. The government has long been criticised for not doing enough. And though South Africa now has one of the largest treatment programmes, it has been slow to get going and reaches only a fraction of the 800,000 or so people thought to need them.

The website does its bit to help. Besides the dating service, it also carries updated research and articles about HIV and AIDS, lists of support groups and treatment centres, and links to resources available to those living with the virus. It is all paid for out of Mr Sassman's own pocket. Membership is free, and getting companies to advertise on the site has been near-impossible. Three years after it was launched, the website has just signed up its first paying advertiser, AllLife, a company offering life insurance to clients with HIV/AIDS.

Even so, the website is now the victim of his own success. According to Mr Sassman, it was the first such service to be set up and has consequently pulled people from all over the world. Although three-quarters of its members are in South Africa, lonely hearts from such places as the United States, Britain, Vietnam, Nigeria and Kenya are regular visitors. The database is struggling to handle the volume of traffic and sometimes crashes. Visitors often have to wait for others to log off before being able to access it. The software needs an upgrade. But that sort of thing is something that Mr Sassman cannot afford.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Russia

The hardest word

Oct 12th 2006 | MOSCOW
From The Economist print edition

Reuters

A murder, a grudge, deportations and what they say about Russia's worrying political direction. Is it time to use the f-word?

"PROVOCATION" is an old Soviet game that can be hard to follow. When two countries employ the same techniques, luring the other into useful folly, it is harder still. In the spat between Russia and Georgia, it has begun to seem that what looked like an overreaction by the Kremlin—and thus a victory, however pyrrhic, for the Georgians—may have a very different purpose and meaning.

The Kremlin loathes Georgia, once a cherished vassal, with the special wrath reserved for wayward loved ones. To the Russians, Mikhail Saakashvili, Georgia's president, is an American puppet, hell-bent on taking his country into NATO, and the arch-carrier of the germ of post-Soviet revolution. For his part, Mr Saakashvili is irate over Russia's meddlesome backing for South Ossetia and Abkhazia, two regions of Georgia that broke away in the early 1990s. Georgia's arrest last month of a handful of Russian intelligence officers (terrorists, insists Mr Saakashvili) may have been a counter-provocation, aimed at garnering international sympathy.

If that was the plan, it probably worked: the Russians went berserk. Even though the men were swiftly deported, Russia recalled its ambassador, evacuated other Russians, severed transport and postal links with Georgia—and then imposed a raft of punitive measures against the legions of ethnic Georgians (many of them Russian citizens) living and working in Russia itself.

In Moscow, hundreds have been arrested and deported (pictured above); celebrities with Georgian names harassed; Georgian-owned businesses raided and closed. The manager of one Georgian restaurant says the staff are in hiding; another says the water has been turned off. The police, meanwhile, asked Moscow schools for lists of children with Georgian surnames, though Dmitri Peskov, a Kremlin spokesman, terms the request a "disgusting" excess of zeal. Now we understand how Chechens living here feel, says a doctor, who like many Moscow Georgians is a refugee from Abkhazia.

New immigration laws, explicitly targeted against Georgians, are promised; so are restrictions on the remittances that help prop up Georgia's economy; Russians allege they contribute to its militarisation. Another hike in the price of Russian gas seems likely (there was one last winter, along with mysterious simultaneous explosions in both export pipelines). Mr Saakashvili may have underestimated the further

damage the Kremlin can do to Georgia. He may also have over-estimated the outside help he can expect. “Russia sees Georgia as a bastion of the West,” he complains, “but the West doesn't.”

For all that, Georgia will survive the confrontation. But can Russia? The Kremlin's escalation of it is an extreme example of another Soviet habit Mr Putin has inherited: using foreign enemies as scapegoats and tools in domestic politics. Past targets have included America, Ukraine, and foreign do-gooders allegedly engaged in espionage. This row comes as anxiety mounts over the question of the succession to Mr Putin when his second (and supposedly final) presidential term ends in 2008. A foreign threat, even a bogus one, will help keep the electorate pliant, whatever the Kremlin decides to do.

This scaremongering is matched by the Kremlin's shifting stance towards xenophobic nationalism, already starkly manifest in a plague of racist murders by skinheads (often un- or under-punished). An anti-Caucasian riot in Kondopoga in northern Russia last month was what once would have been called a pogrom.

Until recently, the Kremlin has tried to “ride the tiger” of extreme nationalism, as Dmitri Trenin, of the Carnegie think-tank in Moscow, puts it, through a risky double strategy: portraying itself as a bulwark against extremism, but also trying to harness nationalist instincts for its own ends. It is widely thought to have created the nationalist Motherland party to siphon votes away from the Communists. (Motherland is now being merged with two other parties into what will become the main “opposition”—almost certainly a completely loyal one). Mr Putin seems now to be giving the tiger freer rein.

For example, he last week enjoined his ministers to protect the interests of “Russia's native population” against the ethnic gangs who, he said, control the street markets. Such gangs are “a reality”, says the Kremlin's Mr Peskov, in justification. But after a racist bombing in a Moscow market killed a dozen people in August, Mr Putin's remarks were at best inadvisable; and in what is—however much some ethnic Russians might wish otherwise—a multi-ethnic country, potentially disastrous.

So, in a different way, might be the growing squeeze on foreign energy firms. Big investments are running into trouble, and after years of dangling the carrot of outside involvement in the giant offshore Shtokman gasfield, Gazprom, the state-run gas giant, now says it will go it alone.

The state's attitude to both business and Georgia demonstrates Mr Putin's failure to create the “dictatorship of the law” that he once promised. Untrammelled by normal constraints such as an independent judiciary or a genuine opposition, the Kremlin makes and breaks laws as it pleases. The growth of racist violence is both evidence and result of a broader lawlessness. Lack of faith in government institutions, and especially in the police, says Eduard Ponarin of St Petersburg's European University, leads some to seek other forms of redress. A recent string of high-profile contract-killings—of a top central banker and of an engineer for a gas company that is in dispute with the government—are another sign of this lawlessness. On October 7th, Anna Politkovskaya, a journalist and campaigner (see our obituary), died in the same way.

According to some (including Mr Putin), her murder was another provocation, designed to discredit the Russian authorities whom she bravely criticised. But whoever killed her, Mr Putin shares the blame for having made independent journalism both rare and perilous.

Dictatorship of the lawless

Russia's huge size and troubled history make any comparisons risky. Yet some see historical parallels in present trends. Yegor Gaidar, a former prime minister, draws an analogy with inter-war Germany, which like post-Soviet Russia experienced economic chaos, then a period of stabilisation in which post-imperial nostalgia took hold. Vladimir Ryzhkov, one of the few remaining independent parliamentarians, worries that Mr Putin seems to be switching from an imperial idea of Russia towards one more resembling a “Reich”.

History also offers a term to describe the direction in which Russia sometimes seems to be heading: a word that captures the paranoia and self-confidence, lawlessness and authoritarianism, populism and intolerance, and economic and political nationalism that now characterise Mr Putin's administration. It is an over-used word, and a controversial one, especially in Russia. It is not there yet, but Russia sometimes seems to be heading towards fascism.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

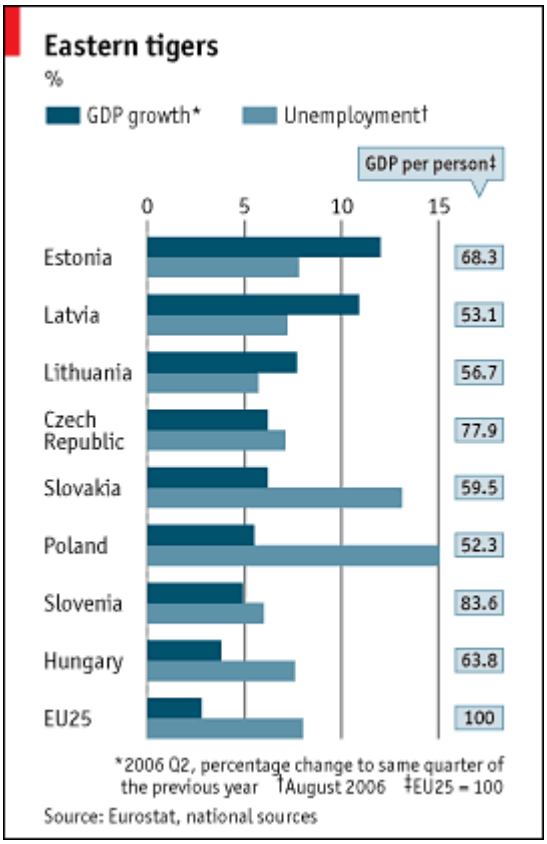
About sponsorship

Central and eastern Europe

Shadows at Europe's heart

Oct 12th 2006 | BRATISLAVA, BUDAPEST, PRAGUE AND WARSAW
From The Economist print edition

The ex-communist countries have been an economic success—but risk becoming political failures



MANY countries would love to have the problems of the EU-8, the eight once-captive nations that joined the European Union in 2004. Sheltered by NATO and locked into the legal architecture of civilised Europe, they are flourishing in a way that seemed hardly possible when they leapt to freedom in 1989. Their economic growth is enviable: Estonia's is a breakneck 12%.

But a more disturbing picture, of livid discontent, declining competitiveness, sleaze and subversion, is lately more prominent. That overshadows not just the fate of the 73m-odd people in the EU-8, and the 30m in Romania and Bulgaria who will join the EU at the year's end. It could dash, disastrously, the EU's already flagging enthusiasm for expansion.

It is tempting to ignore post-communist politics. The countries are mostly small, the names of the politicians as unfamiliar to the outside eye as the differences between their parties. Sides switch, and coats are turned, with bewildering rapidity. Is the ruling People's Party, re-elected in October 8th's election in Latvia, rightwing or leftwing compared with the New Era, which may join it in coalition? Why is the party led by King Simeon of Bulgaria in coalition with the (not very) ex-communists, whose forebears exiled him and murdered his followers? Which Kaczynski twin is president of Poland? Is it the less batty one who is prime minister? Without a patient guide and a large glass of plum brandy, it all seems too intricate and unimportant.

So here is one striking fact. Not a single country of the EU-8 has a strong reformist government. Minority or caretaker governments run the Czech Republic, Poland and Lithuania. Estonia and Slovenia have administrations that are stable but do little. In Slovakia, a new coalition government unites the sleaziest and nastiest parties in the country. Hungary's government is wobbling after the prime minister admitted systematic lying.

In the past three months, the politics of central Europe have turned turbulent. The biggest failure has been in Poland, the most important ex-communist country in the EU. The main governing party, Law and Justice, has ruled for 11 months in a series of shaky coalitions.

It is quarrelsome at home and abroad. Its two leading figures, the twins Lech and Jaroslaw Kaczynski, are respectively president and prime minister. They have repeatedly insulted Germany—which did more than any other country to get the EU to overlook Poland's manifest political and economic weaknesses in the run-up to membership. Now phone calls are not returned, meetings cancelled, cheap historical jibes commonplace. On the flimsiest evidence, Poland's rulers seem determined to believe that Germany is revanchist and hostile.

Sticking up for national self-interest is no crime. Like any other member state, Poland has every right to haggle with the EU. But the tone is amateurish and counterproductive. The former president, the ex-

communist Alexander Kwasniewski, made Poland a trusted Western ally and sounding board, notably in Ukraine. The Kaczynskis sneered, with some justice, at his communist past, glitzy lifestyle and chummy ties with businessmen of all descriptions. But they have turned the diplomatic powerhouse they inherited into a laughing-stock.

There have been unnecessary fights at home too, chiefly with the central bank. Its governor, the peppery Leszek Balcerowicz, may be no loss to diplomacy, but he epitomises the radical economic reform and financial stringency that lies behind Poland's hearty economic growth. Law and Justice is also mystifyingly estranged from its potential coalition allies, the liberal-conservative Civic Platform. No political differences divide them, only a series of petty feuds that should have long ago been buried in pursuit of power.

Unsurprisingly, the government's record is rather thin. It has set up a large and perhaps overmighty anti-corruption unit. Much energy has gone on reform of the military-intelligence service, the WSI, which was certainly a rum outfit. But for many Poles, the issue pales in contrast to other problems. Signally, the government has failed in the fiddly but vital task of applying for and administering the €60 billion ($75 billion) that Poland is due to receive from the EU from 2007 to 2013.

That money—contrary to what some Polish politicians seem to think—does not come free. It is doled out only to properly drawn-up projects, where the home country is sharing at least a bit of the cost, and with audited results. Money misspent one year is clawed back the next. So far only the smallest and best-run countries, Estonia and Slovenia, have learned what to do.

The Kaczynskis' one real advantage was a reputation for integrity. Like many ex-dissidents in power, they made up in honesty and patriotism what they lacked in political savvy or experience. But a new scandal has dented that. Covertly recorded videos showed their party's representatives trying to win over a deputy from the Self-Defence party. “You want a senior position? We've got lots,” says a prime ministerial envoy. He also offers to “sort out” the deputy's legal problems.

Jaroslaw Kaczynski is again trying to put a new coalition together. Early elections are still possible. It is hard to see any strong and sensible government emerging.

The wages of lies

In Hungary, the government has also seen its credibility collapsing—though it arguably had less to start with. Whereas Poland's politics are buffered by strong growth and fairly sound finances, Hungary's are aggravated by the consequences of five years of spendthrift rule.

The prime minister, Ferenc Gyurcsany, was caught on tape telling party colleagues that his government, re-elected in June this year, had lied, screwed up and done nothing. That led to an eruption of public anger, and big losses in local elections this month. Mr Gyurcsany hung on—but this weekend another tape leaked, on which his local government minister, Monika Lamperth, can be heard assuring party chieftains that planned spending cuts will spare Socialist-controlled regions.

The opposition, led by the mercurial and opportunistic Viktor Orban, is little better. Its election campaign was as nonsensical and populist as the slippery ex-communists it affects to despise. Mr Orban and his colleagues seem to have a worryingly soft spot for the racists and ultra-nationalists who took part, sometimes violently, in last month's demonstrations.

Yet Hungary is crying out for good government. Once the reform star of the post-communist world, it is awash with debt, with a government deficit now revealed to be over 10% of GDP—by far the highest in Europe, and more than twice what the government was admitting at the time of the election. Amid the smell of cooked books, foreign investors' confidence has shrivelled. A run on the Hungarian currency, the forint, would mean default and devaluation: a national humiliation, and a disaster for the millions of Hungarians who have borrowed euros and Swiss francs to pay for houses and consumer durables.

The story is little better in the Czech Republic, where an election in June produced a result tied between a conservative-green coalition and the leftist opposition. That has brought four months of political deadlock. A right-of-centre caretaker government failed to gain a confidence vote last week, starting a new round of bickering and arm-twisting. Tomas Lebeda, a political scientist in Prague, says this may go on for a year. Meanwhile no one is even thinking about reforms to the country's creaking pension system. Next year's budget may not be passed on time.

The squabbling takes place against a background of worrying misuse of the security and intelligence services for political advantage. Just days before the general election in June, Colonel Jan Kubice, a senior crime-fighter, presented to a (supposedly) closed session of parliament a report claiming that members of the governing Social Democrat party had been interfering in investigations of organised crime. It also contained gossipy accounts of alleged sexual misdeeds. This leaked to the press, apparently thanks to conservative deputies. Wiretaps in a subsequent leak investigation have prompted even fiercer rows.

All that seems benign compared with next-door Slovakia, where a majority government of racists, populists and authoritarians is beginning to undo the work of the past eight years. Under the rule of the authoritarian populist, Vladimir Meciar, Slovakia had become a playground for crooks and spooks. The government that ousted him in 1998 flattened tax rates, liberalised the labour market, and won billions of dollars of foreign investment.

Elections in June produced an ambiguous result. A reformist coalition was possible, but instead the largest party, Smer, a populist outfit calling itself social democrat, teamed up with Mr Meciar's party and the outright racists of the Slovak National Party. On paper, the government seems committed to free-market policies. In practice, it sounds muddled—and clumsy. At a foreign investors' conference there last month, a senior government figure, Peter Ziga, addressed a roomful of bewildered foreign executives in Slovak, without translation. Worse, public institutions are again being politicised.

There are some slivers of good news. Lithuania's minority government is proving tough-minded and competent. In the presidential election in Estonia, the electoral college, by a perilous single vote, chose Toomas Hendrik Ilves, a brainy and eloquent American-educated émigré, over a candidate backed by an unscrupulous populist party closely tied to Russia.

Voting with their feet

If post-communist countries cannot raise living standards to western levels, and improve radically the quality of their public services, more people will vote with their feet. Since barriers to movement within Europe were largely lifted in 2004, more than 2m have headed west. Most don't want to emigrate permanently. But almost all complain that as workers and as citizens, they feel poorly treated at home, ill-paid, and frustrated by economies where connections matter more than talent.

For all the strides made in past years, the sad truth is that no ex-communist country has fully reformed its public administration. Voters may be richer, but they also feel cheated and put upon by bossy bureaucrats and snooty politicians. The optimism of 1989 seems sadly distant.

The danger now is that even the bravura economic performance of the past few years may fizzle. Russia and Ukraine offer great supplies of cheap labour, not much farther away. Romania and Bulgaria make the EU-8 look expensive. Emigration tightens the labour market still more.

So brainpower in the service industries, rather than cheap, nimble fingers in manufacturing, should be the new wellspring of wealth-creation. But education systems are rigid and rife with cheating. Most universities are disgracefully old-fashioned and introverted, run by self-interested bureaucracies, mediocre to their roots. Research and development spending is under 1% of GDP—worse even than the puny 2% average of western Europe.

If competitiveness is one worry, financial stability is another. The World Bank said recently that fragmented and populist governments were not only hampering reform but “complicating fiscal and macroeconomic stabilisation”. Bloated public administration makes most ex-communist governments chronically spendthrift. So far, booming tax revenues disguise the problem; that could change all too quickly.

None of the seven ex-communist states outside the euro (Slovenia squeaked in and will adopt it on January 1st) is likely to join this decade. Yet small open economies cannot have an independent monetary policy (indeed, several have currency boards) and are vulnerable to external shocks and speculative attacks.

Discontent and populism may now form a vicious circle, both causing economic failure and worsening it. Ivan Krastev, a Sofia-based political scientist, believes that a political model based on clear ideological differences, mass memberships and strong party loyalties may have once worked well in “old Europe” but

has signally failed to transplant to “new Europe”. The gulf between the political elites and the people is growing, and it is hard to see what will bridge it.

If global financial markets tighten, the extraordinary willingness of foreign savers to finance the consumers and bureaucrats of post-communist Europe could shrivel almost overnight. That vulnerability is now matched, dangerously, by unlovability. Western countries might be prepared to bail out their eastern neighbours, financially or politically, when they are seen as valiant, fast-reforming success stories. When run by incompetent and prickly populists, it may prove to be another story altogether.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

France

Sound and fury

Oct 12th 2006 | PARIS
From The Economist print edition

A French immigration crackdown but an amnesty (see article) in Spain

Reuters

The untidy issue of deportations

MEDITERRANEAN Europe tends to deal with illegal immigration by periodic amnesties, allowing tens of thousands to remain each time. France, home to between 200,000 and 400,000 illegal immigrants, mostly from West Africa and the Maghreb, is now trying a new tactic: throwing them out. It is proving tricky.

In August Nicolas Sarkozy, the hard-talking interior minister and the centre-right's leading presidential candidate for next year's elections, ordered police to enforce a court order evicting 508 people from a squat in a disused university building in Cachan, outside Paris. Those found to be in France illegally would be “escorted back to their country of origin”. Past amnesties, he said, simply spurred more inflows. Now it was time to enforce the law.

Many Cachan squatters refused the hotel rooms initially offered, fearing deportation if the group was split up. The Socialist mayor of Cachan opened a local gym instead; they unrolled mattresses and settled in. Opposition politicians and celebrities dropped by to show solidarity. Two top French footballers, Lilian Thuram and Patrick Vieira, invited 70 squatters to an international match against Italy.

At first, Mr Sarkozy stuck by his tough line. In mid-September he announced that ten ex-squatters had already been expelled. But two of six hunger strikers had to be taken to hospital. The gym became worryingly squalid. Mysteriously, the numbers squatting there grew. Last week, Mr Sarkozy sent in mediators, including from liberal campaigning groups such as SOS Racisme, who struck a deal: the squatters would leave for temporary housing, so many could stay together. Applications to stay in France would be examined individually. Even so, the gym is emptying slowly.

Mr Sarkozy insists he will never accept “mass regularisation” of illegal immigrants. The Cachan squatters, he adds, were exploited for political ends. Ifop, a polling agency, says that 52% of the French approved the original eviction.

But the saga illustrates the difficulties of a hard-line approach. Earlier this summer, the government agreed to treat individually the cases of immigrant families with children in school. Some 30,000 applied, nearly 7,000 were accepted. Of the rest, few have actually been thrown out. Though half the original Cachan squatters were illegal, only 16 have been expelled. And with no border controls with Italy and Spain, France must live with its neighbours' amnesties (see article).

Perhaps the outcome matters less than the gesture. Mr Sarkozy knows full well that if he does not sound tough on immigration, Jean-Marie Le Pen of the far-right National Front will gain. A year after rioting in the *banlieue*, fears about illegal immigration are bound up with worries about crime and security. Mr Le Pen beat the Socialist candidate into the 2002 presidential run-off against Jacques Chirac. If the mainstream does not sound muscular on immigration now, a repeat of that in 2007 cannot be ruled out.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD EUROPE
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Spain

Huddled against the masses

Oct 12th 2006
From The Economist print edition

When immigration policy fails, try giving up

IN MANY ways, Spain's Socialist government has done better than outsiders expected. But it lacks an immigration policy. Spanish television screens show daily boatloads of exhausted Africans arriving illegally at the Canary Islands. And Spaniards now say immigration is one of their worst problems. Some 60% put part of the blame on their government.

More than half a million foreigners have arrived for each of the past three years. Some 700,000 illegal immigrants were granted amnesty last year. So the issue is hardly new. But the questions it prompts are becoming tougher. Can Spain absorb more people? Can it afford not to?

The Socialists do not seem to have an answer. “The labour market has absorbed all it can,” said José Blanco, a senior party official, recently. “Spain will continue needing immigrants for a long time,” replied the government's employment chief, Valeriano Gómez.

The scale of Spanish immigration makes angry debates in other European countries look trivial. Some 650,000 people arrived last year, pushing the total population over 44m. Italy, Europe's second-biggest migration magnet, managed barely half that.

Immigrants now make up 8.7% of the population—a fourfold increase in just six years. Those turning up so telegenically in the Canary Islands are, at 21,000 over a year, just a detail. Most step off flights from Latin American countries and walk straight into jobs on building sites or as household helpers.

Spain has benefited in many ways. Social-security receipts have increased, postponing a pensions crisis. Migrants have stoked demand, helping annual GDP growth reach 3.7%. They have even turned around the country's declining birth rate. And they have kept labour costs down.

Josep Oliver, from Barcelona's Autónoma university, reckons Spain will need 4m extra workers by 2020. With their families in tow, that would put the immigrant population at 10m, or almost a fifth of what may then be the total. His study suggests Spain may need even more, with up to 9.8m if growth continues apace. Even if growth is low, 2.3m will be needed.

That is because native Spaniards' birth rate is so low. An average señora will bear just 1.35 children in her lifetime. “Collectively we decided not to have children and, without knowing it, we decided to have immigrants,” says Mr Oliver. To show he has a grip on the issue, the prime minister, José Luis Rodríguez Zapatero, must tell voters to expect more newcomers, not fewer. That will take courage.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Belgium

Right on

Oct 12th 2006 | ANTWERP
From The Economist print edition

At last, the far right is becalmed

Reuters

No one wants to dance with us

ANTWERP is a city known for diamonds, fashion, and as home of one of Europe's biggest, and until this weekend, most successful far-right parties, Vlaams Belang (Flemish Interest). It campaigns for independence for Flanders, repatriation of unassimilated immigrants and the repeal of Belgium's anti-discrimination laws. In local elections on October 8th, it took around one-third of the vote in Antwerp and increased its tally of councillors across the northern Flanders region.

Vlaams Belang, known until 2004 as Vlaams Blok, broke into the mainstream in 1991, in an election liberal-minded Belgians still call “Black Sunday”. Since then its vote has risen, seemingly unstoppably. Even a ruling by Belgium's highest court that it was racist and discriminatory merely led to the change of name and a more careful public tone. It received €6.8m ($8.5m) last year in state funding.

Now it has stalled. It polled 20% in Flanders, down from 24% in the 2004 regional elections. Though it won more votes in some places, nowhere was the share big enough to bust the complex coalition deals that keep it out of power.

As well as right-wingers, the party attracts protest voters and moderate Flemings who fear that though larger and richer, Flanders loses out in Belgium's federal system. Francophobia is Vlaams Belang's big strength—and weakness. The lack of a francophone partner means that they do not fare as well in national elections.

Sunday's vote also foreshadows a defeat for the Liberal prime minister, Guy Verhofstadt. His VLD party lost heavily across the country. That makes the Christian Democrat leader, Yves Leterme, his likely successor, in coalition with the Socialist Party. If Vlaams Belang advances further in the 2007 parliamentary elections, however, the Liberals may stay as the junior partner of a tripartite coalition constructed to block the far right. Belgium's political establishment can keep Vlaams Belang from power, but no mainstream party wants its votes.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD EUROPE
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Sweden

Electric power

Oct 12th 2006
From The Economist print edition

A flying start—and minor scandals—for Sweden's centre-right government

WHO said Swedish politics was grey and boring? The new centre-right government includes the first black and the first openly gay ministers in Sweden's history, as well as the first male pony-tail. The prime minister, Fredrik Reinfeldt, is aged only 41. He is his country's youngest prime minister in 80 years.

Burying a previously prickly relationship, Mr Reinfeldt has also appointed a predecessor, Carl Bildt, as foreign minister. Prime minister until 1994, Mr Bildt has since then become his country's foreign-policy heavyweight, serving as the European Union's man in Bosnia-Herzegovina and as the United Nations' Balkan envoy. He has passionately championed further EU enlargement, not least on his prolific blog. Its fans hope protocol will not cloak his powerful intellect and sharp pen.

Mr Reinfeldt has also parachuted in some lively minds from outside politics. Cecilia Stego Chilo, who runs Timbro, a free-market think-tank, has gained the culture ministry. Her bracing remarks about the need for more entrepreneurship in the world of culture have terrified a pampered cultural world long dependent on taxpayer handouts.

Even more infuriating for the country's leftist establishment was the choice of a Burundi-born Swede, Nyamko Sabuni, as minister for integration and equality. Herself a model of integration and proficiency in Swedish, Ms Sabuni wants compulsory medical checks of schoolgirls for genital mutilation, and prosecutions of parents who inflict it.

The front bench also includes probably the world's first pony-tailed finance minister, Anders Borg (inside his head, he's an ultra-solid banker), and as trade minister a prominent technophile science journalist, Maria Borelius.

All of these new faces send a strong signal to Swedes that something new is under way. Unluckily for Mr Reinfeldt, his first week in the job was tainted by a whiff of scandal. Ms Borelius admitted she had dodged taxes by paying her nanny cash-in-hand. Ms Stego Chilo, whose portfolio includes public-sector broadcasting, confessed to having failed to pay her television licence for 16 years.

Mr Reinfeldt faced down whoops of disapproval from the opposition Social Democrats. As leader of the first majority government since 1981, he can afford to ride over a few bumps.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

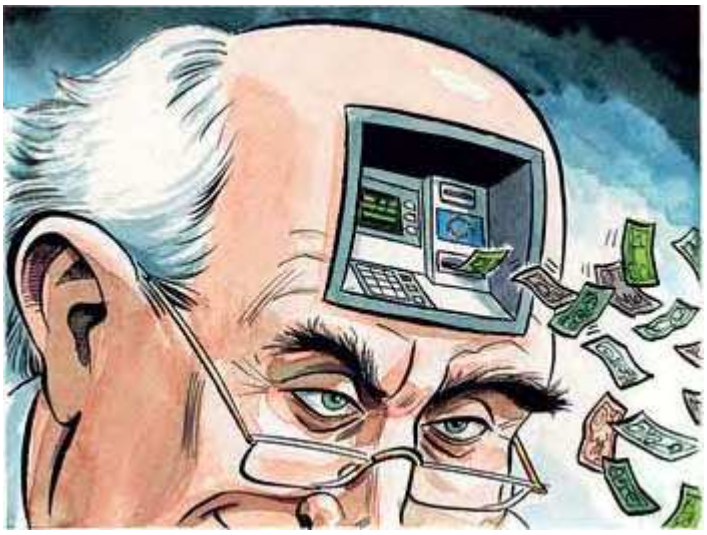
PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Charlemagne

The brain business

Oct 12th 2006
From The Economist print edition



How Europe uses and abuses its brainpower

WHICH country is best at fostering and using knowledge and skills? The answer to that might also tell you which country will be most successful economically since knowledge is held to be the key to growth; the European Union has grandiloquently set itself the target of becoming “the most competitive and dynamic knowledge-based economy in the world”.

Until now, though, it is been frustratingly hard to measure who is fostering knowledge best. Instead, there have been partial indicators, such as who spends what on research and development. Or there have been indicators of something slightly different, such as competitiveness rankings compiled by the World Economic Forum, the organisers of annual conferences in Davos.

Hence the value of a brave stab at measuring knowledge and skills, broadly defined. It comes from two European think-tanks, the Lisbon Council in Brussels and the Frankfurt-based Deutschland Denken (Think Germany), and has been devised by Peer Ederer of the Zeppelin University in Friedrichshafen.

Mr Ederer's scorecard has four columns. First comes a country's knowledge base or, as economists call it, “human-capital endowment”. This is the imputed value of all the effort that has gone into educating and training everyone in the country. Formal study is part of it, but so is the value of time spent parenting. Results here vary surprisingly widely between countries, with Sweden doing brilliantly and Italy poorly.

This column also includes adult education and in-house training by companies. In turns out that these have at least as big an impact on a country's ability to create knowledge as the relative performance of its education system does. The resulting score for human-capital endowment is then depreciated, for what is called, with delightfully euphemistic tact, “obsolescence in the knowledge base and some level of forgetting”.

Next comes employment. It is no good training people and giving them splendid skills if they don't have a job, so the second measure is “human-capital utilisation”. That is a bit like a traditional employment rate but weighted for education, training and the rest of it. And as it is not much use training people and giving them jobs if they are working inefficiently, the study therefore includes a third measure, of productivity, to capture how well a country is using knowledge. It divides economic output by the human-capital stock (normal productivity measures, in contrast, divide output by the number of hours worked).

Lastly, Mr Ederer included demographic change, since even if a country has well-trained people, with good jobs, working effectively, its knowledge base will still decline if low fertility means its working-age population is shrinking.

Putting that lot together, you come up with an overall score. European countries divide into three groups: A-grade students (with Sweden easily the best, followed by Denmark, Britain, Austria and the Netherlands); muddlers in the middle (Finland, Ireland, France and Belgium); and lastly duffers who ought to be held back a year (Spain, Portugal and—oddly—Germany, with Italy trailing way behind).

In some ways, these grades might not look all that surprising. They are similar to what you would get if you looked at countries' general economic management over recent years: the Nordics (including Britain and Austria as honorary members) are doing well; Mediterranean and large continental economies are in trouble. But surprising or not, no one has worked out the impact of knowledge like this before.

There are also revealing details. Finland has, by most measurements, the best education system in Europe, perhaps in the world. Yet it is outstripped on Mr Ederer's scorecard by Sweden and Denmark. Why? Because Swedes and Danes invest more time than anyone else in bringing up children (generous laws on parental leave, perhaps?). They put skilled people to work: 63% of the national knowledge base is in productive use in Denmark but only 55% in France and a measly 52% in Italy; that's a big gap.

The study casts light on why France is doing so well in some ways but so badly in others (it has high unemployment, yet its multinationals are world-beaters). When skilled people are put to work in France, they are highly productive: the country scores well on the productivity ranking. French demography is also favourable. But the country is falling way behind in creating a knowledge base (it scores badly on the human-capital endowment ranking) and it is signally failing to put people to work.

Germany's late for its exams

More worrying, though, is Germany, perhaps the most striking failure among countries in the study. It continues to churn out highly trained people (it comes fifth on the endowment ranking). But it is not to putting them to work: the average age at which Germans graduate from university (at master's degree level) is 28 years, one of the highest in Europe. And its demographic indicators are flashing red: Germany and Italy between them account for 70% of the total decline in western Europe's workforce in the next 25 years.

No one would say these indicators are perfect (they almost certainly understate Ireland's knowledge base, for instance). But because human capital is the main determinant of economic performance, they at least provide a rough guide to future success. Sweden is better placed than its recent election might lead you to think (the result was a demand to reform the “Swedish model”). Germany and Italy are doing worse than they seem.

The study is also a timely reminder that much European debate on innovation and the “knowledge economy” is woefully inadequate. The next time you hear Europeans talking excitedly about increasing research and development spending, as they will undoubtedly do at next week's EU summit, remember that such efforts are only a tiny part of the wider task of building and deploying knowledge.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

National Health Service

Handing over control

Oct 12th 2006
From The Economist print edition

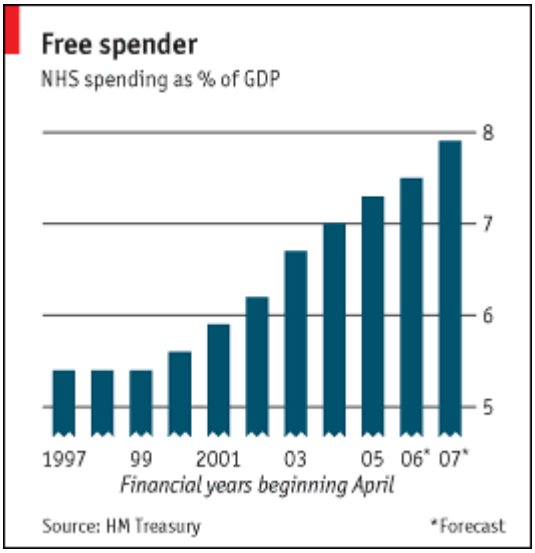
Promises to make the NHS independent offer a false prospectus

Getty Images

Get article background

THE National Health Service will spend £96 billion ($178 billion) this financial year. This enormous budget—bigger than most of the world's economies—will gobble up nearly a fifth of total government expenditure. The decision in 2000—made virtually off the cuff by Tony Blair in a television interview—to force-feed the NHS with extra money for the best part of a decade was a defining moment in his administration. As a result, publicly financed health spending will reach nearly 8% of GDP next year, compared with 5.4% when Labour took office in 1997 (see chart).

Historically, politicians have kept the NHS on a tight rein in return for the taxes that pay for it. With so much extra money now going into the health service, the case for tightening that grip might appear unanswerable. Yet, remarkably, both the men jousting for Mr Blair's inheritance say they want to make the NHS independent.



Gordon Brown, the chancellor of the exchequer and favourite to succeed Mr Blair, set out this ambition last month. David Cameron, the Conservative leader, will have to wait until the next election for his chance to become prime minister. But he, too, wants to emancipate the NHS, as he spelt out in a speech on October 9th.

For Mr Brown, the policy would be a feat to match his early decision to make the Bank of England operationally independent. The success of that reform, which has helped keep the economy stable over the past nine years, still redounds to his credit. Offering to repeat the trick with the NHS may help to get rid of the “control-freak” label that hinders his prospects of becoming and remaining prime minister.

The policy appeals to Mr Cameron for a different reason. He knows that the electorate's distrust of the Conservative Party as a steward of the NHS has played a big part in its election defeats over the past decade. Mr Cameron told the Tory party conference last week that his priority could be spelt out in three letters: “NHS”. His new commitment to make it independent is designed to dispel doubts that he was just grandstanding.

Politics may explain why the proposed reform has become so voguish, but what matters is whether it would make the NHS work better. The policy has obvious merit compared with Labour's incessant interference in the health service for most of its nine years in office. Ministers have tested micro-management to destruction, setting reams of detailed targets that have tied managers and doctors in knots, often with damaging side-effects. For example, the campaign to reduce waiting times has entailed high rates of bed occupancy, which make hospital infections like MRSA more likely to spread.

With good reason, Labour ministers are no longer so keen on targets. The government has retained some crucial objectives, notably the pledge to achieve by 2008 a maximum all-in waiting time for elective treatment, from a family doctor's referral to the operating table, of 18 weeks. But the Health Department now highlights patient choice rather than targets as the way to chivvy along the NHS.

Indeed independence can be seen as the logical step in a chain of recent reforms that mark Labour's retreat from the top-down target regime. These are turning the health service into an internal market in which primary-care trusts (PCTs)—local purchasing organisations—can increasingly buy health care from private providers as well as publicly owned hospitals. Independent treatment centres are expected, for example, to provide 7-8% of publicly financed elective care by 2008.

In the past, the NHS was virtually synonymous with its publicly owned hospitals. These traditional providers will remain important as one arm of the new health service, but PCT-led commissioning is becoming an increasingly significant second arm. The underlying purpose of the NHS is ceasing to be the public provision of health care. Instead it is becoming the purchase of medical treatment from any provider, public or private, as long as it is free at the point of use.

The Conservatives' proposal in effect formalises this split. Ministers would remain responsible for the total amount of money spent on the health service, as well as the scope of what it covers. But an independent NHS board would be given responsibility for allocating resources, commissioning services and raising standards. Meanwhile, a new economic regulator would authorise providers and promote competition between them. An inspectorate based on the Healthcare Commission (see article) would act to ensure that quality standards were met.

In practice, however, it will be difficult to divorce the NHS from political control. The Bank of England does not provide a pertinent model. The bank has a clear target—keeping inflation at bay—which it can achieve by altering the cost of money. By contrast, there will always be a range of political objectives for the NHS, some of which involve tricky compromises such as the trade-off between the quality of medical care and its cost. And there is scant agreement on how best to achieve these goals in health care (whereas, with the bank, there is no doubt that interest rates can be used to control inflation).

This won't hurt enough

Even if it were realistic to make the NHS independent, this may not be the right time. The health service is at last moving in the right direction—towards greater choice and competition—but only because of the impetus for reform that has been driven by Mr Blair. An independent NHS board would find it much more difficult to force the pace of change.

A case in point is the planned rationalisation of hospital services. Pushing through such unpopular closures of emergency facilities requires political will. The Conservatives' backing for an independent NHS would command greater credibility if they were not intent on opposing these overdue reductions in excess capacity through their populist campaign to “Stop Brown's NHS Cuts”.

Labour's recent reforms have sought to improve the health service by increasing the play of market pressures—for example, through a payments system that ties hospital budgets more closely to how busy they are. But as long as the taxpayer continues to pay for the NHS, it is surely idle to suppose that politicians can, should or will surrender control over the health service by making it genuinely independent.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

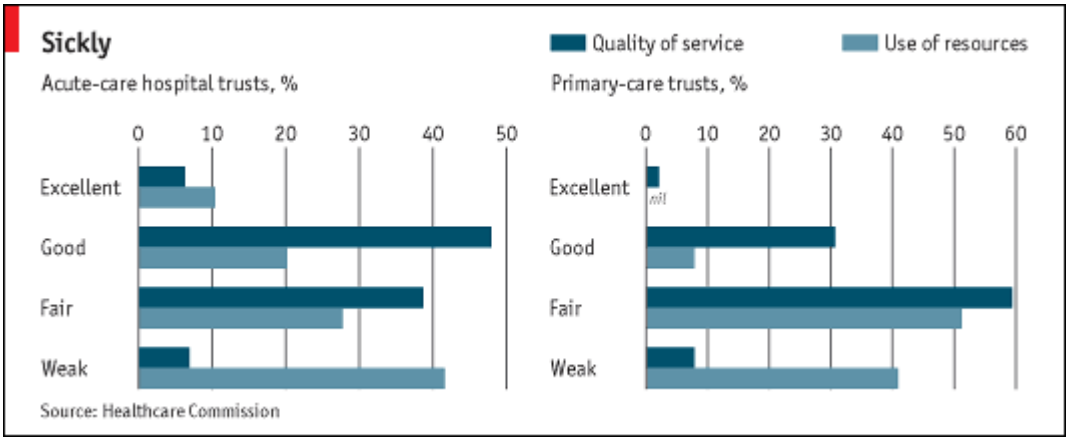
About sponsorship

Health-care performance

A poor report card

Oct 12th 2006
From The Economist print edition

The NHS fails its own bewilderingly complicated health check



Get article background

WHETHER or not the National Health Service is granted greater independence from politicians, the vast sums of public money flowing into it demand close scrutiny. The Labour government set up the Healthcare Commission to provide an independent check on the quality of NHS services in England. On October 12th it delivered a damning indictment.

Almost half of the hospital trusts that provide acute care were rated only “fair” or “weak” on quality. Primary-care trusts, which buy health care for the patients living in their areas, did even worse, with two-thirds in the lowest two categories (see chart). A rating of “weak”—the lowest grade possible—means that the trusts have just 30 days to come up with an action plan to sort themselves out.

Unsurprisingly, after a year of headlines about health-service deficits, the financial performance was even worse. More than four in ten hospitals, and a similar proportion of primary-care trusts, were rated weak in their use of resources. However, foundation trusts—high-performing hospitals that have been granted extra freedoms, including the ability to borrow money—did well, with more than half rated excellent in their use of resources and none as weak.

The commission's report card marks a new approach to monitoring performance in the NHS. It replaces the previous “star ratings”, which rolled all the indicators into just one, ranging from no stars at all for poor performance to three for excellent. Now that the results for quality have been unbundled from those for finance, trusts can no longer blame a poor overall rating on a dodgy financial performance.

The headline ratings are supposed to summarise a heap of data. The “quality of service” measure, for example, compresses indicators based on 24 core standards, 20 existing national targets, 24 new national targets and seven reviews of specific services. For the core standards alone, hospitals had to fill in a 68-page form, answering questions ranging from the general (“Please give examples of initiatives to reduce anxiety about admission and treatment for children and young people”) to the very specific (“Where is the designated endoscopy washroom situated?”).

Hospitals' returns were then compared with information already held by the commission, such as surveys and figures from other regulators. Where they seemed suspiciously upbeat the commission carried out further checks, which led to a downgrade for a quarter of all the standards examined. Even more

worryingly, the commission also carried out some random checks, one in eight of which led to a downgrade, suggesting that trusts' self-assessments were not very reliable.

The commission hopes that its findings will be used to help patients choose between hospitals, one of the government's main policies to improve the NHS. The findings are all available online and can be searched by postcode or name of institution. Scores can be broken down into their components, and results for each standard and target examined separately.

But are the right things being measured? “The commission is faced with the problem of auditing quality without any data on outcomes,” says Nick Black, a professor of health-services research at the London School of Hygiene and Tropical Medicine. “So instead it asks whether hospitals are carrying out the processes it thinks they should be.”

Mr Black is part of a team trying to work out a better approach. Their idea is to survey patients three months after an operation to find out how they are doing. He reckons this would cost around £20 ($36) a head—a tiny fraction of the cost of a typical treatment. In return, hospitals and the commission would get really useful data, individual doctors' performance could be monitored, and it would be possible to evaluate new surgical techniques and devices. Most important, patients would get the information they need when choosing where to have an operation.

The commission's findings are probably best interpreted as a useful guide to rather than a definitive imprimatur on NHS performance. The quest for better ways to measure the quality and effectiveness of doctors and hospitals must continue. It is a priority not just in England but in all developed countries as the cost of medical care continues to soar.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

British Muslims

Deconstructing the veil

Oct 12th 2006
From The Economist print edition

Why Britain is so het up about Muslim women covering their faces

BOOK burnings are rare in Britain. Before 1989, when copies of Salman Rushdie's novel “The Satanic Verses” were incinerated in two cities, anyone searching for a really good literary bonfire had to look back to the religious upheavals of the 17th century. The Rushdie affair became a defining issue for a generation of British Muslims, and the argument over whether free speech is worth the occasional blasphemy has been smoking ever since.

This week Mr Rushdie, whose provocative prose earned him a *fatwa* and years of police protection, intervened in another row about Islam—over whether Muslim women who wear veils that cover everything but their eyes should take them off in public. His judgment? Veils “suck”.

The row over veils has aroused massive public interest and is starting to resemble the anguished debate that took place in France over the ban on headscarves in schools. It began when Jack Straw, leader of the House of Commons, revealed on October 5th that he asked veiled women who came to see him at his constituency in Blackburn to show their faces. Mr Straw said that he opposed passing laws on what to wear, but that veils make talking harder and emphasise separateness, and are therefore bad for community relations. He was backed this week by Gordon Brown, the chancellor of the exchequer, who added that immigrants should learn English and familiarise themselves with the Magna Carta.

Compared with previous clashes between the government and Muslims, the response to Mr Straw's plea for visible noses and mouths has been muted. The Muslim Council of Britain said Mr Straw was playing into the hands of people who hated Islam. A few hotheads tried to blame him for an attack on a woman wearing a veil. But there were no banners, marches or burnings.

Relatively few women wear veils. Informed guessers reckon that between 10,000 (the more likely estimate) and 40,000 of Britain's 800,000 Muslim women wear one. That number seems to be increasing, though. An influx of people from Yemen and parts of the Gulf where wearing a veil is the norm is one reason. But the practice is spreading beyond this group, to the 75% of British Muslims who are from Asian families. Many of those now covering up are the British-born children of immigrants, whose mothers do not wear veils themselves.

Two main reasons are commonly given for why more young Muslim women are covering up. First, it is a political statement, an in-your-face version of a “Free Palestine” T-shirt. Ghayasuddin Siddiqui of the Muslim Parliament points out that headscarf wearing blossomed among Muslim women in Britain after the Iranian revolution in 1979, and thinks something similar is happening now.

Second, Muslim women supposedly put on veils for reasons that blend feminism with religion. Though they are often pressed by their own families not to cover up, some choose to wear a veil out of disgust at the amount of flesh on display on television or on the high street, because they dislike being ogled by men, and because a veil makes them feel safer.

“Personality dictates whether women wear a veil or not,” says Salma Yaqoob, a councillor in Birmingham who campaigned against the war in Iraq. Ms Yaqoob cites her own family as an example: she does not wear a veil, her sister wore one for a while but has now taken it off, and her mother wears one whenever she feels like it. Wearing the veil is, she says, a private matter.

Yet whatever the precise reasons for Muslim women covering up, the row has unveiled tensions within Britain. The main worry is about whether a formerly easygoing approach towards integrating ethnic communities is still working.

According to a Populus poll published in the *Times* this week, 69% of Britons think that Muslims make a valuable contribution to society—up ten points since the summer. But this broad approval is fragile: 60% told the same pollsters then that Muslims are viewed with suspicion by other Brits. The veil hardly helps to dispel such feelings, which is why some Muslims share Mr Straw's concerns. It is also a symbol of a separateness that no longer seems acceptable after London was attacked by home-grown suicide bombers last year.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

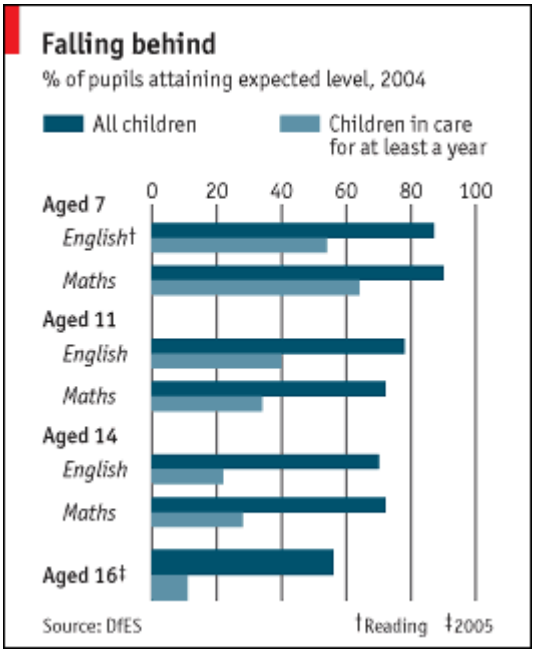
About sponsorship

Children in care

A better deal

Oct 12th 2006
From The Economist print edition

How the government plans to help the most vulnerable children



ALEXIA HAMMOND first came into care at the age of five and then again when she was a teenager. She lived with six foster carers before settling at a children's home in Ealing in west London. She gained 12 GCSEs, four A-levels, a good degree and is now studying on a postgraduate course.

The government is the carer of last resort for around 60,000 children. Most of them fall into public hands because their parents abused or neglected them. The enduring image of children in care is of crying babies in children's homes. In fact most are aged ten to fifteen and foster parents look after over two-thirds of them.

In that respect, Miss Hammond's experience is quite typical. But her educational success makes her the exception. The caring state does a bad job in helping its charges get a good education—the best passport to a happier future. At every level in schools, children in care do worse than their peers (see chart). The older they are, the more they fall behind. By the time that they are 16, little more than a tenth of children in care get decent GCSE grades. Only 6% end up going to university compared with 38% of their peers.

This educational failure is a blot on Labour's record. Since it won power in 1997, it has spent a lot of money on these children. It has also overhauled the services that look after them. But ministers know that if the children do badly at school they will have difficult lives as adults, with poor job prospects and a heightened risk of homelessness and mental illness.

On October 9th Alan Johnson, the education secretary, admitted that the system was “still failing”. He outlined plans to sort out the mess. His overriding objective is to create as much stability as possible for the children. Last year, for example, 13% of them moved three or more times. This often entails changing schools as well as foster parents. The children lose friends and their education suffers.

The government's proposed reforms cover three main areas. First, it wants to prevent children from falling into care. Already, some fragile families are offered intensive support and help with problems such as alcohol or drug addiction. All councils will now be expected to provide this kind of help.

Second, ministers want to improve the quality of care. Since foster parents look after most of the children, it is essential to get them to make a better fist of it, especially in motivating their charges to do well at school. The government will ginger up their training, including special help in looking after disturbed children. And it intends paying them more. Children in care will also get the chance to go to the best state schools, even if they are full. More will be able to attend boarding schools.

Third, the government will devote more resources on those leaving care. At present many leave home early and struggle. The changes will mean that students will get a grant of £2,000. Others can stay in foster care until they are 21.

All these changes should certainly help. So, too, will another reform. The government intends beefing up competition in the provision of care by encouraging businesses and children's charities to bid to look after

groups of children in care.

However, one intractable problem remains. After a series of child-abuse scandals in the 1980s, carers are wary of showing the affection that neglected children need. Mr Johnson agrees that love is lacking. Instead, his ministers are offering better “corporate parenting”. This ghastly piece of jargon encapsulates a worthy objective—that all those responsible in one way or another for the children should demand the same quality of services for them as they would for their own children.

This model has been inspired by councils like Ealing. Six years ago it created a homely centre for those in care. The staff offer help with homework and other skills. Anthony Dawes, a youth worker there, is particularly proud of the kitchen in which the youngsters learn to cook. The teachers organise trips to the opera and restaurants.

The tender approach seems to work. Miss Hammond fell ill during her finals. “The workers texted me, they sent flowers, they believed in me.” Mr Dawes agrees. “It's about being cared for, not just about shelter and food.” It might not be love, but it is the next best thing.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Overcrowded prisons

A predictable crisis

Oct 12th 2006
From The Economist print edition

Why the home secretary is scrabbling to find more prison places

JOHN REID became home secretary because of a prison scandal. His predecessor, Charles Clarke, was forced to resign in May after admitting that some 1,000 foreign prisoners who ought to have been considered for deportation had been freed. This week Mr Reid faced a prison crisis of his own, made worse by new figures showing that offenders released early from jail on electronic tags have committed more than 1,000 serious crimes.

In theory, the jails of England and Wales can accommodate just over 80,000 people. By October 6th they were just 210 short of that limit. The obvious remedies—cramming two people into cells built for one, letting more prisoners out on probation and moving convicts far from their families—have already been taken. So, last-ditch measures were put in place this week. Some 500 police cells will be used for prisoners. Foreign convicts' appeals against deportation will no longer be contested, in order to liberate their beds. Others will be paid to go home.

This is one of history's less surprising crises. By the late 1990s Home Office statisticians were not only predicting a rapid rise in prisoner numbers, but also erring on the side of pessimism. Eight years ago, when the prison population was just above 65,000, the department predicted that it would rise to 83,000 by 2005. In 2002 the statisticians' forecasts were also too pessimistic. Yet the politicians still appear to have been caught by surprise.

One reason the prisons are full is that there are more police officers—141,000, compared with 122,000 in 2000. They can now go after crimes that are hard to crack but attract long sentences, such as drug-trafficking. The number of people in prison for drug offences has trebled since 1994. And, while the overall crime rate in England and Wales is improving, it may be that some criminals are worse. Cindy Barnett, a London magistrate, reckons the defendants she sees are more violent and have graver drug problems these days. That helps to explain why magistrates sent 27% of robbers straight to prison in 2004—up from just 10% in 1993.

In the past few years, the Home Office has prodded judges and magistrates to punish serious, violent offenders more heavily, while encouraging them to go easier on petty thieves. The former has certainly happened: the number of life sentences has more than doubled since the early 1990s. The latter has not. Populist politicians forgot that judges tend to have fixed ideas about the relative seriousness of offences. Force them to increase sentences for murder, and they will also hand out longer terms to armed robbers.

Finally, there is media pressure. Tabloid newspapers such as the *Sun* and the *Daily Mail* hound judges who pass, or even seek to justify, lenient sentences. This week the *Sun* accused one wig of “living in an ivory tower”. Because most people's experience of the criminal-justice system is rare and intermittent, such coverage strongly influences the public mood. Ivory towers notwithstanding, it also stings judges. Penny Darbyshire, an academic who has been following wigs for several years, says they pore over press coverage. “And many of them have wives who read the *Daily Mail*,” she says.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Power generation

King Coal redux

Oct 12th 2006 | SELBY, YORKSHIRE
From The Economist print edition

High gas prices have revived the steam-age fuel but its dirtiness may hinder an enduring comeback

OVER the past few years, windpower has seemed more relevant than coal in shaping the future of electricity generation. Helped by generous subsidies, windmills are now whirring away up and down the land. More recently, the government's energy review in July signalled a possible nuclear revival. Coal—the dirtiest of the fossil fuels—was expected to fade gradually away in the power game.

Such thinking seems to have passed by south Yorkshire, where the skyline is dominated by the colossal cooling towers and chimneys of Drax, Britain's biggest coal-fired power station. Despite the talk of a future powered by the wind, the sun and the atom, Drax has been running flat out for months and is currently generating 7% of Britain's total electricity needs.

Indeed, coal power is back in fashion to a surprising extent. It now supplies 34% of Britain's power, up from 28% in 1999. The reason for the renaissance, says Jim Skea, director of the UK Energy Research Centre, is the high gas price, which has encouraged power generators to switch from gas-fired stations to coal-fired ones in an attempt to save money.

Drax itself has come back from the dead. Four years ago the plant was put into administration. Several buyers subsequently circled round it, but none was willing to pay more than £200m. By 2004, offers ten times as high were being made. In June 2006 the company returned to the FTSE100, and it recently reported bumper profits of £317m in the first six months of the year.

The power market is notoriously fickle, and the prospect of new import capacity has pushed gas prices down sharply in recent weeks. But longer-term factors may favour the future of coal in electricity generation. For one thing, it offers greater security of supply than oil and gas. Coal reserves around the world are vast, widely dispersed and readily available from stable countries such as Australia and America, points out Martin Brough of Oxera, an economics consultancy.

Spooked by sudden spikes in the gas price, ministers are increasingly swayed by such arguments, which have added weight now that Britain has become a net importer of oil and gas. The government hinted strongly in the energy review that it wanted to keep coal in the power mix, promising to set up a group that will secure the “long-term contribution of coal-fired power generation.” By contrast, its previous review three years ago hardly discussed the fuel at all.

In a warming world, dirtiness remains coal's biggest drawback. A standard coal plant produces around three times as much carbon as a gas station. Coal fans hope that new technologies—such as “washing” away impurities that boost carbon emissions—can clean it up. The ultimate prize is carbon capture and storage, which removes carbon dioxide from the exhaust gases and stores it for disposal in depleted oil and gas fields. That would solve the emissions problem at a stroke, but it could more than double the cost of coal generation.

However, expensive technical fixes may not be needed to give coal power a future. A simpler option, says Mr Brough, may be to exploit the carbon market. After all, the point of the market is to allow cuts in emissions to be made by the industries that can do so most cheaply. They can then sell their emissions allowances to dirtier businesses. Coal plants already spend millions of pounds buying such permits. “Having a carbon market removes the objection that coal is too dirty,” says Mr Brough. So even without a technological revolution, the steam-age fuel may yet hold its own in the future.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Bagehot

An old man who's not in a hurry

Oct 12th 2006
From The Economist print edition

A settlement in Northern Ireland is possible, but Ian Paisley will not be rushed

Get article background

SOMEONE who has laboured long and hard to achieve a final settlement between the warring parties in Northern Ireland likens the peace process to the old Irish weather forecast: “If you can't see the top of the mountain, it's raining; if you can, it means it's about to rain.” That said, as three days of supposedly last-chance negotiations to restore devolution got under way at St Andrews in Fife on October 11th, the political weather seemed to be set as fair as it ever gets in that damp and misty province.

Certainly the British and Irish governments believe there is no longer any insuperable obstacle preventing Ulster's politicians from putting their squabbles to one side and doing a deal. They are fed up with the “virtual” politics that has existed since Stormont was suspended four years ago after a row over IRA spying. During that time the members of the Northern Ireland assembly have drawn their generous wages and expenses, while being unwilling to make the moves necessary for them to carry out their jobs properly as elected representatives of the people.

Although deadlines have slipped in the past, the British are adamant that a deal must be reached within the next four weeks. Otherwise what they call Plan B will be put into action after November 24th. Quite what this consists of has been kept deliberately vague—“we don't want to be accused of bullying or making people's flesh creep,” says an official—but those salaries will be stopped and Stormont will close. With a looming general election in Ireland and a change of prime minister in Britain next year, the attention of both governments will be elsewhere if this chance is missed. Tony Blair has other things he wants to do before he departs and Gordon Brown, if and when he succeeds, will be more concerned with winning over the voters of middle England than in banging heads together in Northern Ireland.

What has reinforced the conviction of both governments that progress is now possible was last week's well-timed, but nonetheless historic, verdict of the Independent Monitoring Commission. It found that the IRA really has dismantled its military structures and is now firmly bearing down on the remaining criminal activities of some of its members.

That leaves only two (related) points of issue between Ian Paisley's Democratic Unionist Party (DUP) and Sinn Fein, both tricky and important, but capable of solution with the right choreography. Mr Paisley says that before there can be any return to power-sharing, the republicans must accept the legitimacy of the Police Service of Northern Ireland (PSNI). Gerry Adams, Sinn Fein's leader, this week indicated that his party was close to doing precisely that. If Mr Adams were to call a special conference before November 24th to confirm his party's support for the PSNI, perhaps the DUP could then make the leap of faith necessary to deal with the second issue—its willingness to accept Sinn Fein as a partner in a power-sharing executive.

With Mr Paisley in a newly benign mood—witness the old bigot's unprecedented and apparently good-humoured meeting on October 9th with Archbishop Sean Brady, the Catholic primate of Ireland—and Mr Adams desperate for a breakthrough that would bolster his party's flagging prospects in the Irish election, the conditions for a deal exist.

The devil, as usual, lies in the detail. Sinn Fein insists that policing and justice should be the responsibility of the devolved executive, preferably with a republican minister in charge. The DUP says that Sinn Fein has to prove its commitment to the forces of law and order over a period of time, likely to be years not months, before it should have a hand in running them. Compromise is possible, but if both sides stick to their theological positions, there will be no agreement by November 24th.

Unfortunately for the optimists, it is not at all obvious that agreement is even in the DUP's interest just yet. Somewhat unfairly, given the time and energy that Mr Blair has put into the peace process since 1997, Mr Paisley would much prefer not to reward him with a deal on what remains of his watch. This is not, as some have suggested, because he prefers that son of the manse, Mr Brown, to the crypto-Catholic, Mr Blair.

Rather, it is because of Mr Blair's place in the DUP's narrative of the last nine years. First, he was the architect of the hated Good Friday agreement. The story then continues with Mr Blair constantly trying to prop up David Trimble, the doomed leader of moderate unionism, while at the same time appeasing IRA foot-dragging. According to its own myth, only the DUP was able to change the terms of political trade from the Trimble era by calling the IRA's bluff when Mr Blair had refused to do so.

Nor does it fit in with Mr Paisley's own personal narrative to compromise because of the threat to stop the pay cheques. He is the man of unbending principle, not a venal office-seeker.

Deal or no deal

Even the awful possibility of the province being run indefinitely by Peter Hain, the bumptiously ambitious secretary of state for Northern Ireland, is not quite the secret weapon the British government imagines. Mr Hain, who wants to be Labour's next deputy leader, could soon be off. And, anyway, Mr Hain has proposed the setting up of seven “super councils”, which could provide enough democracy for most unionists for the time being. Given a choice between a deal now and one after the next British general election in about three years' time, Mr Paisley, if not some of the younger modernisers in the party, probably prefers the latter. For the DUP, peace without devolution is not such a bad option.

Mr Blair is in a hurry because time is running out for him; Mr Hain is in a hurry because he needs a boost to his deputy-leadership credentials; Mr Adams is in a hurry to return to government in the north before next year's Irish election. But the 80-year-old Mr Paisley is in no hurry at all.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Your television is ringing

Oct 12th 2006
From The Economist print edition

“Convergence” is the telecoms industry's new mantra. Whether customers really want it is another matter, says Tom Standage

WHAT has come over the telecoms industry? The spectacular crash of 2001, with its associated bankruptcies, fraud and the destruction of around $1 trillion of investors' money, has evidently been forgotten. The gloom has given way to a fresh sense of opportunity and a renewed frenzy of dealmaking. The past couple of years have seen a series of huge takeovers and mergers among network operators and makers of telecoms equipment around the world.

In America SBC paid $16 billion for AT&T, took its name, and then swallowed BellSouth for a further $67 billion. Its rival Verizon, meanwhile, bought MCI for $8.4 billion. In Europe Telefónica, Spain's national incumbent operator, bought O_2, a wireless firm with networks in several European countries, for £17.7 billion ($31.3 billion). NTL, Britain's cable operator, bought Virgin Mobile, a mobile operator, for £962m. Vodafone, the world's biggest mobile operator by revenue, signalled a retreat from its global ambitions and sold its Japanese arm to Softbank, a local wireline broadband operator, for $15.4 billion.

In addition to these and many other deals, operators around the world began building “next-generation networks” at vast expense. Verizon is spending over $18 billion on its new network, and Britain's BT is spending £10 billion. These networks allow telecoms operators to offer television service in addition to voice calls and broadband internet access.

Meanwhile, large internet companies including Google, Yahoo! and Microsoft's MSN marched into the telecoms business by launching new services offering free calls over the internet. Skype, the leader in this market, was acquired by eBay for $2.6 billion. And equipment-makers began teaming up too: Cisco, the world's largest network-equipment firm, bought Scientific-Atlanta, which makes television set-top boxes, for $6.9 billion; Alcatel and Lucent agreed to merge in an $11 billion deal; and Nokia and Siemens combined their network-equipment divisions.

At first sight these deals might not appear to have much to do with each other. But all of these transactions were prompted by a single underlying trend that has become the industry's new mantra: convergence.

All together now

What this means, roughly, is the coming together of previously separate communications and entertainment services: fixed and mobile telephony, broadband internet access and television. But more often the word is used in a quasi-mystical way to evoke information heaven. “Convergence really means the freedom for consumers to use any service under any circumstances they choose to,” says Ben Verwaayen, the boss of BT. “It is a question of convenience, enriching people's lives, because we can provide communications, information and entertainment the way they want it,” says Mark Wegleitner, chief technologist at Verizon. “We want to bring simplicity to our customers, the first step towards digital paradise!” exclaims Didier Lombard, the chairman of France Telecom.

In fact, although the industry likes to depict convergence as a great boon for customers, it actually involves a technological shift that, in the first instance at least, will primarily benefit network operators. At its heart, convergence is the result of the telecoms industry's embrace of internet technology, which provides a cheaper, more efficient way to move data around on networks. On the internet everything travels in the form of “packets” of data, encoded using internet protocol, or IP. The same system can also be used to encode phone conversations, text and photo messages, video calls and television channels—and indeed anything else.

It is only relatively recently that IP technology has matured to the point that it can carry these other services reliably and efficiently, says Basil Alwan, the president of IP activities at Alcatel. But now that it has happened, operators can replace a jumble of different networks for services such as voice, data and video—each with its own order-entry, billing and fault-reporting systems—with a single network on which everything travels as interleaved streams of IP packets. “The ultimate goal is to have one IP infrastructure, and services running on that infrastructure,” says Mr Alwan.

This convergence affects not only wireline networks, but wireless ones too. Today, operators run separate but interconnected networks for fixed and mobile phones. But the new converged networks are “access agnostic”. In short, a single core network may have a variety of devices connected to its edges via different technologies. Traditional fixed-line phones might be connected via wires; mobile phones via base-stations; and televisions or computers via broadband telephone lines or Wi-Fi links.

Access agnosticism should enable a mobile phone, say, to connect to the core network via Wi-Fi in the home and then switch seamlessly to a traditional cellular connection outdoors. The core network remains untouched as new access technologies (such as fibre-optic links or new kinds of high-speed wireless data technology) are added to its edges. In an industry that loves obscure acronyms, the framework for linking everything up in this way is known as IMS, TISPAN or NGN.

“IP in a converged world enables one network, many services, any access,” says Robert Lloyd of Cisco. A converged, all-IP network of this kind has two immediate technical advantages for network operators, he says. The first is that it costs less to run, thanks to its far simpler architecture and the economies of scale associated with internet standards. BT, a firm widely regarded as a pioneer in the switch to next-generation networks, expects its operating expenses to fall by 30% once its new “21st Century Network” (21CN) is completed in 2009. “By 2010 you will have to look very hard to find a fixed or mobile operator that is not running its traffic over an IP core,” says Mr Lloyd.

The second advantage is that in theory, new services can be added far more quickly and easily, without the need to add any new network infrastructure. Adding a new service amounts to little more than adding software to the core of the network and perhaps some new access technologies around the edges.

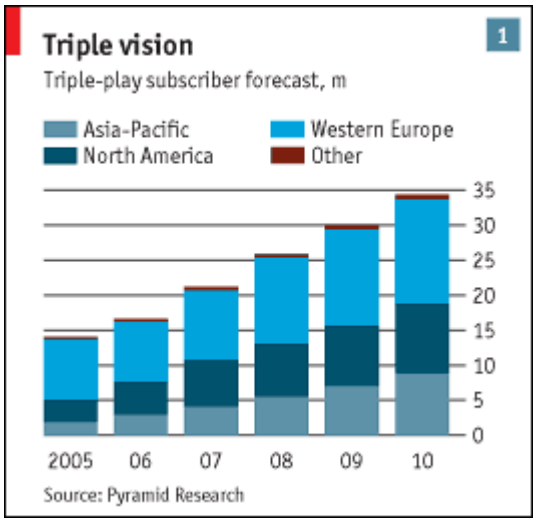
The rise of the quadruple play

Because of the convergence on IP networks, companies that used to be in separate industries—telephone operators, internet-service providers and cable-TV firms—suddenly find themselves in the same business. Cable companies now offer broadband internet and voice services over networks that used to carry just television, and telecoms firms have upgraded their networks to carry television signals. In the new converged world any firm that can deliver an IP stream to customers over its network can offer any or all of these services. And offering several of them together, many operators believe, is a winning strategy.

Hence the current scramble to offer the “quadruple play”—the name given to the combination of fixed and mobile telephony, broadband internet access and multichannel television. This explains many of the deals that have taken place in recent months. AT&T, which is already rolling out a fast new network to carry TV signals, bought BellSouth in order to win full control of Cingular, its wireless joint venture, and complete the quadruple-play package. Softbank, which already offers television, voice calling and

internet access over fixed broadband links under the Yahoo! BB brand, bought Vodafone Japan to add mobile to the mix. Similarly, NTL bought Virgin Mobile, and America's big cable operators last year struck a deal with Sprint Nextel, a wireless operator.

The desire to offer a one-stop shop for quadruple-play services has also prompted several national incumbent operators to reabsorb their previously separate wireless operations. And it has hastened consolidation among telecoms-equipment vendors, such as the Alcatel-Lucent and Nokia-Siemens deals. Large operators have concluded that buying as much as possible from a single equipment-maker increases their bargaining power and avoids problems with integrating equipment from different suppliers.



Operators claim that selling all four services together as a bundle makes life easier and more convenient for customers. “Customers in our experience really want that,” says Ed Whitacre, the swashbuckling Texan boss of AT&T and one of the most vocal proponents of the merits of bundling, “and we can give them a better price.” The average American household spends $176 a month on telephone, broadband and television services, according to figures from Parks Associates, a consultancy. Mr Whitacre's stated aim is to reduce costs by building a converged network, and to offer the quadruple play for as little as $100 a month.

There is indeed evidence that customers like the discounts associated with bundles and the convenience of a single bill. “Customers are much more open to purchasing via the bundle,” says Mikal Harn, vice-president of consumer marketing at AT&T. For the incumbent telecoms operators, however, the quadruple play is all about protecting their core business of fixed-line voice calls, which still accounts for the bulk of their revenues.

Their problem is that fixed-line subscribers are being lured away by cable operators and voice-over-internet firms, or are getting rid of their fixed lines in favour of mobile phones. During 2005, for example, the number of fixed telephone lines operated by Verizon, America's second-largest telecoms firm, declined by 8%. Its losses were greatest in the New York metropolitan area, where it faces the most competition from cable operators offering voice services, says Stephan Beckert of TeleGeography, a market-research firm.

As cable operators offer customers the “triple play” of voice, broadband and television, telecoms operators have concluded that their best defence is to respond in kind and also to throw in wireless, which many cable operators are not yet able to offer. Customers who sign up for a bundle of services and its associated discount cannot defect to a rival provider of any one of the services without losing the discount. “We make the product more sticky—customers don't seem to leave,” says Mr Whitacre. Similarly, cable operators are using bundles to protect their core business, which is not voice but television, as it, too, comes under attack from satellite-TV providers and now telecoms operators.

Another benefit of bundling everything together is that it reduces advertising, customer-acquisition and other marketing costs, because all the services can be advertised together under a single brand. That is why France Telecom recently rebranded its Wanadoo broadband division and Equant corporate-networks division to align them with Orange, its far stronger mobile-phone brand. This will allow the company to sell bundles of services to both consumers and businesses under a single brand. “It cost a lot to support all those brands, so it's very rational to choose the most popular brand in the collection to support all our products,” says Mr Lombard. Similarly, doing away with the old SBC, BellSouth and Cingular brands in favour of the much stronger AT&T brand is “a huge opportunity for us”, says Mr Harn.

Shades of 3G?

Convergence and bundling, in short, are two sides of the same coin. The convergence of multiple networks makes bundles of services cheaper to provide; and the business logic of bundling makes the cost of building new, converged networks easier to justify. But anyone familiar with the telecoms industry may be experiencing a sense of déjà vu. This is the same industry that spent tens of billions of dollars building new fibre-optic networks in the late 1990s, in anticipation of a surge in traffic that never materialised. The result was a spectacular crash.

Meanwhile, European operators paid around €100 billion for licences to build new high-speed “third-generation” (3G) mobile networks. They hoped that as revenue from voice calls levelled off, the new networks would open up a lucrative new data-services market. But take-up of data services fell far short of expectations, and 3G's real value proved to be much less exciting: an ability to cut operating costs and provide lots of cheap voice capacity. This caused huge write-downs in the value of the licences. Both of these episodes are now regarded as embarrassing collective hallucinations over which the industry prefers to draw a veil. But might the same thing happen again with convergence?

“What problem is convergence solving?” asks Andrew Odlyzko, an expert in the economic history of telecoms at the University of Minnesota. “It is solving complexity issues for service providers, but it is not actually solving much for consumers.” Guy Zibi, an analyst at Pyramid Research, a telecoms consultancy, is equally sceptical: “It's the technology department driving the marketing department.” As with 3G, he says, operators are rushing to provide new services even though consumer demand is unclear and the technology is still immature.

Even some people in the industry, such as Arun Sarin, the chief executive of Vodafone, have their doubts. As a wireless-only operator, Vodafone could find itself high and dry if convergence does indeed prove to be the next big thing. But so far Mr Sarin has taken a cautious view of convergence, prompting much criticism of his strategy. Despite some recent convergence-friendly tweaks to its business model, including moves into the fixed-line broadband market in Britain, Germany and Italy, Vodafone's main focus is still on mobile. “It's very early days,” says Mr Sarin. “We are dubious that customers really want all the things that people are imagining that they want.” In particular, it is wrong to assume that everyone wants quadruple play, he thinks: “We're not saying that there are no customers who demand this—we're saying it's a very small fraction of customers.”

So far, the evidence seems to prove him right. Only 1% of consumers in Italy, 8% in France and 10% in Britain have signed up for triple-play bundles of fixed-line voice, broadband internet and television, according to figures from Forrester, a consultancy. In a survey it carried out, 44% of European consumers said they were not interested in such service bundles, though 49% said they might be interested if there was a discount. But if operators have to offer steep discounts to get people to sign up for their bundles, it will be harder for them to justify the expense of building new converged networks.

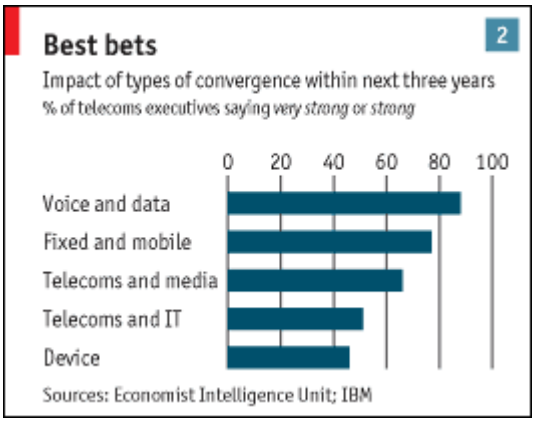
Ready or not, here it comes

True believers in convergence insist that it is about more than simply bundling existing services together: it will make new services possible, too. Many operators are already getting excited about “fixed-mobile convergence”, in which a single handset can be used both as a mobile phone outdoors and to make cheap calls via a fixed line at home or in the office. Another oft-cited example of a new service made possible by convergence is to enable customers to programme their digital-video recorders remotely, either via the web or from a mobile phone.

Mr Verwaayen, a passionate football fan, talks enthusiastically about the idea of combining television with audioconferencing, so that a group of friends can watch a match “together” from different locations.

Many operators are experimenting with security cameras that sit in your home, or perhaps your holiday home, and allow you to keep an eye on the place from your mobile phone or over the web. And there is the prospect of integrating your telephone with your television, so that when you are watching a film and someone calls you, the caller's name appears on the screen and the film pauses automatically if you pick up the phone.

Convergence, then, promises operators both the means to defend themselves against competitors today and the prospect of new revenues tomorrow. According to a survey published last year by IBM, a computer giant, and the Economist Intelligence Unit, a sister company of this newspaper, 80% of telecoms executives surveyed agreed that it was essential to embrace convergence within the next three years as a source of long-term revenue growth. The same survey also asked respondents which converged services and markets they thought were likely to prove most important (see chart 2). The clear leader was voice-data convergence, followed by fixed-mobile convergence and telecoms-media convergence. And these are, indeed, the three areas where convergence is most visible.



This survey will examine the prospects for convergence by looking at each of these areas in turn. Of the three, voice-data convergence is clearly the most mature (think of the popularity of Skype, an internet-calling service that is now practically a household name) and provides the strongest evidence of the power of convergence to reshape the industry. Fixed-mobile convergence is less advanced, though the first commercial services are now available in some countries. Telecoms operators' move into the television market is also at an early stage, though there have already been some notable successes.

Whether or not convergence turns out to merit the hype, the industry has convinced itself that it is worth pursuing, and anyone who disagrees risks being left behind. “As soon as one operator adopts convergence, all the others have to follow,” says Mr Lombard. Quite how far and how fast the process will go remains to be seen. But like it or not, convergence is coming.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

All things to all men

Oct 12th 2006
From The Economist print edition

Two other kinds of convergence

PART of the attraction of convergence is that it covers so many different things. “If you ask five people what it means, you'll get seven different viewpoints,” says Stephen Bye, who is in charge of “wireless and converged services” at AT&T. In addition to the broad trend of convergence between voice, data and entertainment services, and the networks and companies that deliver them, the term is also used in at least two other senses that are worth a brief glance.

The first is the convergence between the worlds of telecoms and computing, otherwise known as information technology (IT). These have long been two industries separated by a common love of technology. For many years there was networking the telecoms way (generally expensive, proprietary and reliable) and the computer way (generally cheap, standards-based and sometimes flaky). But now the two worlds are starting to look more similar as internet standards and technologies spread.

Telecoms networks are becoming ever more reliant on software and complex computer systems to handle service delivery; computing, meanwhile, is beginning to look more and more like telecoms as software is increasingly delivered as a network service and companies are increasingly dependent on their networks to keep things running. Hence the advance of the big systems integrators into telecoms services, and the move of telecoms firms into IT services. This trend is real enough, but it is not central to most telecoms operators' strategies.

A remote control for your life

The second is “device convergence”. Everything from a laptop to a mobile phone to a television to a games console is now, arguably, the same kind of device: each consists of a microprocessor, a screen, some storage, an input device and a network connection. You can make phone calls on your laptop, play games on your mobile phone and watch videos on your games console. This has prompted much speculation about convergence on a single powerful device that can perform all of these functions.

But although the various kinds of digital device look increasingly similar on the inside, they look increasingly different on the outside. Just look at the huge range of mobile devices, from basic handsets that simply deliver voice calls to BlackBerry-type e-mail terminals and multimedia handsets that let you watch TV on the move. “We have to be extremely careful that we don't go in the Swiss army knife kind of direction where we lose focus on what the consumer wants,” says Olli-Pekka Kallasvuo, the boss of Nokia, the world's biggest handset-maker.

Jack-of-all-trades handsets have generally not sold very well. So Nokia's range of “converged” devices, the Nseries, consists of a variety of devices with specific strengths: as a music-player, a mobile TV or a camcorder, in addition to being a phone. The trend is not towards a single converged device, but towards a greater diversity of hybrid devices. Not so much convergence, then, as divergence.

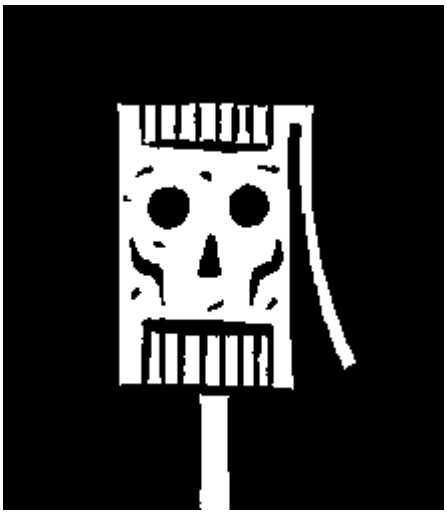
Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

The end of the line

Oct 12th 2006
From The Economist print edition

Traditional fixed-line telephony has had its day



IT WAS the industry's bread and butter for over a century. But the end is now in sight for traditional telephone service, which will soon be overtaken by voice-over-internet calls in terms of usage, and displaced by broadband internet access as the core revenue-earning service offered over fixed lines by telecoms firms. And even if the traditional telephone is not quite dead yet, its business model certainly is: metered telephone calls whose cost depends on the length of the call and the distance covered are becoming an anachronism.

The demise of traditional telephony can be charted in two ways: by looking at the proportion of call traffic carried using voice-over-internet-protocol (VoIP) technology, which already exceeds 50% on some routes and seems to be heading towards 100%; and by looking at the cost per minute of calls, which appears to be heading inexorably downwards, thanks to VoIP's far lower costs and higher efficiency. VoIP is cheaper because instead of establishing a dedicated circuit to connect two callers, it encodes the telephone call as a two-way stream of data packets that are sent over a high-speed internet connection. This encoding can be done either by a computer running a piece of software such as Skype, the most popular VoIP provider, which now has more than 100m users; or it can be done by a small box, called an analogue terminal adapter, which allows a standard telephone to be plugged into a broadband connection.

VoIPocalypse now

Sending packets across the internet is free once you have paid for your broadband subscription, so calls that travel entirely on the internet, such as those between two Skype users, cost nothing. If you use a VoIP service to connect you to a traditional telephone, the call travels mostly across the internet but pops out onto the local phone network at the other end; the owner of that network then charges a fee to deliver, or “terminate”, the call, typically no more than a local call. All this reduces the price of telephone calls dramatically. Indeed, Niklas Zennström, the co-founder of Skype, believes that voice calls will eventually cost nothing. “You don't pay for each e-mail or each web page you load,” he says. “It's the same with phone calls. That's where it's going. It will be free.”

Aside from undermining the pricing model of a trillion-dollar industry that still makes most of its money from voice calls, VoIP is disruptive in other ways, too. VoIP phones can have traditional phone numbers associated with them. But they work wherever they are, provided they are plugged into the internet, making a mockery of geographical conventions such as area codes. So you can assign, say, a San Francisco phone number (area code 415) to your phone, take it to another country, plug it into a broadband connection and have people in San Francisco call you for the price of a local call.

More subtly, VoIP decouples the two previously intertwined components of telephony: access to the network (via a wire running into your house, for example) and service (the ability to make and receive calls). Traditionally, access and service have been provided together. But with VoIP you can buy broadband access from one firm (a cable operator, say) and a telephony service from another (such as Vonage). So owning the access network no longer confers a monopoly on voice service; conversely, it is possible to offer a voice service without owning an access network.

The result has been a surge of innovation and competition as new entrants flood into the market. The spectacular failure of Vonage's initial public offering—the firm's share price collapsed after it floated on

the NASDAQ exchange in May—did not signal a lack of confidence in VoIP; it merely demonstrated that Vonage now faces serious competition in a market it helped to pioneer. According to Infonetics, a market-research firm, VoIP-based telephone services worldwide had 24m residential subscribers last year; by 2009 the number is forecast to reach 131m.

Let computer speak unto computer

Those figures exclude computer-to-computer VoIP calling, which is also growing fast. The success of Skype has prompted big internet firms, including Google, Yahoo!, Microsoft and AOL, to launch similar services, which allow free calls between computers and very cheap or free calls between computers and traditional telephones. That is why Skype sold itself to eBay for $2.6 billion last year, Mr Zennström explains. “We thought it would be good for us, as we get into competition with big internet companies, to be part of a big internet company ourselves.”

Businesses are also embracing VoIP, which allows them to use a single network to carry both voice and data within and between offices. To start with, the attraction of VoIP was simply cost reduction, says Cisco's Mr Lloyd. His company, which competes neck-and-neck with Nortel to be the leading supplier of VoIP telephony equipment, has sold over 9m desktop VoIP phones. New buildings and offices now routinely have a single network installed, rather than separate phone and data networks, he explains. Sales of traditional switchboard equipment are in decline, whereas sales of IP-enabled equipment are growing at a rate of about 30% a year. Already, more than one-third of large North American companies have adopted VoIP, and two-thirds will have done so by 2010, according to Infonetics.

Having started out as a means of reducing costs, VoIP phones are now being adopted because of the new features they offer, says Mr Lloyd. With a VoIP-based phone system, office workers can sit down at any desk and log into the phone, which instantly becomes their extension. They can also use VoIP phones at home or in hotel rooms, making and receiving calls just as though they were sitting at their desks. “It completely decouples us from location—my office is wherever I happen to be,” says Peter Carbone of Nortel, via his VoIP phone. VoIP also allows call-centre operators to work from home, making it easier to match the number of workers to fluctuating demand.

If you can't beat 'em, join 'em

All of this is a decidedly mixed blessing for telecoms operators. On the one hand they have been able to reduce their own costs by adopting VoIP internally to carry calls around their networks. Telecom Italia, for example, began using VoIP for all phone calls between Rome and Milan in 2002, reducing costs by 60%, says Stefano Pileri, the company's chief technologist. Once BT completes its “21st Century Network” in 2009, all calls will travel across the network as VoIP calls, though customers will still be able to use their old telephones. Being able to handle voice calls cheaply, as just another stream of data, is one of the benefits of building a converged network.

On the other hand most operators still derive most of their revenues from voice calls, so the inexorable decline in voice revenue as consumers and companies adopt VoIP strikes right at the heart of their business. According to figures from Informa, a market-research firm, global revenues from fixed-line voice calls were around $600 billion in 2005, and data revenues were $202 billion. By 2010, it predicts, fixed-line calls will account for less than half of operators' revenues in the developed world. Instead, their new core product will be broadband internet access.

“This is the key dilemma for the telecoms industry,” says Mr Odlyzko of the University of Minnesota. “Voice is still what matters the most, it is still 70-80% of revenues for the industry worldwide, and it's going to zero in price. So how do you handle that transition?” Forrester, a consultancy, reports that voice revenue is now falling by 10% a year at France Telecom, 6% at Deutsche Telekom and 5% at BT. The same sort of thing is happening in America, Japan and other developed countries.

Incumbent telecoms firms around the world have responded to VoIP in a number of ways. Some Middle Eastern countries have banned VoIP and blocked access to Skype's website, in order to protect their incumbent telecoms firms and ensure that phones

can continue to be tapped (which is very difficult to do with VoIP). But in the developed world regulators take a dim view of such practices, so operators have had to respond in other ways. To start with they switched to new pricing structures, reducing their call charges and raising their monthly line-rental charges instead. Many operators have now done away with call charges altogether and instead offer unlimited local, national and even some international calls for a flat monthly fee.

Incumbent operators also reluctantly began launching low-cost VoIP services of their own, because their customers were defecting to VoIP providers, and a VoIP customer is better than no customer at all. “Obviously, even if it disturbs the business model of traditional voice, you cannot stop it—it's ridiculous to fight against progress,” says France Telecom's Mr Lombard. Instead, he says, incumbents must now try to capture as much as possible of the new VoIP market. For example, France Telecom has differentiated itself from VoIP competitors by using the technology as the basis of its new “Voix Haute Définition” (high-definition voice) service, which enables hi-fi quality audio connections between subscribers. Other operators, including BT, have launched similar products. Operators around the world, including AT&T and Verizon in America, also offer VoIP services which customers can use over any broadband connection.

Bundling provides incumbent operators with another defence against VoIP. They might choose to offer subscribers a triple-play bundle in which voice is “free”—ie, the subscriber pays only for the broadband and television services at the usual rates. Some cable companies and alternative operators (which run fixed-line phone networks in competition with incumbents) are already doing this: Free Telecom in France, for example, includes unlimited national calls to fixed-line phones, as well as a selection of free television channels, with its broadband service. Conversely, some firms offer free broadband to telephone subscribers. Of course, nothing is really free, insists BT's Mr Verwaayen. “Where voice, data and video are interchangeable, it's very difficult to allocate cost to one service or another,” he says. “The word 'free' can only be used once, and you can randomly choose the component you make free.”

Mr Wegleitner at Verizon thinks the threat from firms like Skype and Vonage is overstated, because they cannot offer the same range of services as a network operator. “I question the long-term viability of those solutions,” he says. “Can a VoIP supplier really compete with a full-service provider like a telco or a cable company?” On this view, the real threat to incumbents comes more from cable operators offering cheap (or “free”) VoIP services than from pure-play VoIP companies.

But Mr Zennström insists his company will stay ahead of the game. This has now moved on to enhancing communications in new ways, he says, by integrating voice calls with videoconferencing, instant messaging, “presence” services that show whether someone is available, file transfers and other social-networking and collaboration tools. “Beyond the zero price point you need to start offering better services, unleashing and enhancing telephony using IP networks,” he says.

Trouble in the air

Even if their voice revenues vanish altogether, fixed-line operators do at least have a booming new business in the form of broadband internet access, global revenues from which will grow from $202 billion in 2005 to $410 billion by 2011, Informa predicts. That will help to make up for the decline of voice, and some operators believe that new broadband services such as television will actually enable them to increase their overall revenues. Mobile operators, however, are in a very different position. They rely even more heavily than fixed-line operators on revenue from voice calls, and despite years of effort and the construction of new high-speed “third-generation” (3G) networks, they have been unable to convince their subscribers to embrace data services.

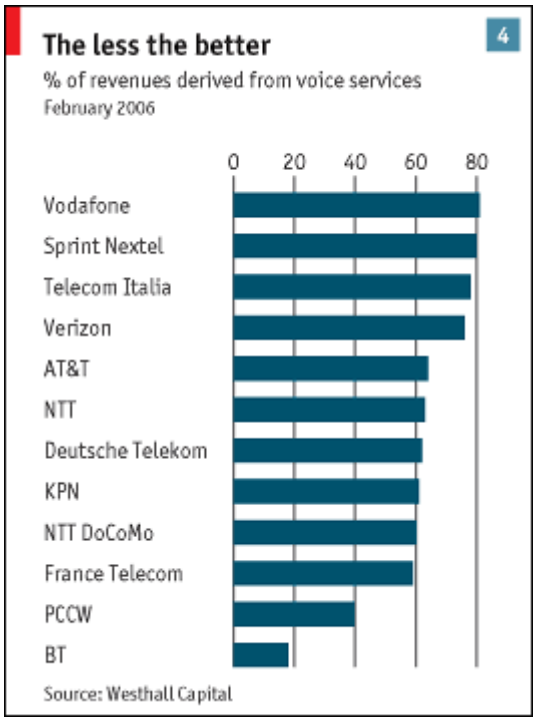
This makes them extremely vulnerable to the spread of VoIP to mobile phones. Convergence of networks implies convergence of prices, argues Cyrus Mewawalla, an analyst at Westhall Capital, and mobile prices are typically three to ten times higher than fixed-line prices. The majority of mobile operators depend on voice for over 80% of their revenues, and voice prices “are likely to fall close to zero in an internet-centric world,” he says. He notes that each new telecoms technology spreads more quickly than the last: fixed-line telephones took 50 years to reach 50% of the population, mobile phones took 20 years, the

internet ten and broadband five in some parts of the world. Mobile VoIP could be widespread within two or three years, he thinks.

The emergence of a Skype-like piece of software that could be downloaded onto a 3G phone and used to make VoIP calls could be “lethal” to mobile operators, says John Barrett of Parks Associates, a consultancy. Operators offer data communications far more cheaply than voice, often in the form of flat-rate data packages, so subscribers could avoid call charges and roaming charges by using a VoIP program to disguise their mobile calls as data traffic. Operators could block access or degrade the quality of their data services, but that would antagonise subscribers. Cutting voice prices to make traditional mobile calling more attractive would decimate their revenues, and raising data prices to discourage VoIP calling would erect more barriers to the take-up of their new data services upon which the operators are relying for future growth. “They are between a rock and a hard place,” says Mr Barrett.

For the time being, he says, getting VoIP to work on a mobile handset would be too fiddly for most people. But as handsets start to resemble pocket computers, with downloadable games and other software, the threat of mobile VoIP looms ever larger. Ironically, as mobile operators race to upgrade their 3G networks to offer wider coverage and higher transmission speeds, they also increase their vulnerability to VoIP.

So what can mobile operators do? Some of them are already experimenting with mobile VoIP, says Mr Zennström, as a means of differentiating themselves from their competitors. In particular, E-Plus, a German mobile operator, has a partnership with Skype that allows subscribers to its unlimited 3G data plan to use Skype on the move for a fee of €40 ($51) a month—though they still have to use a laptop computer with a wireless-data card rather than a mobile phone. E-Plus is doing this mainly to sell wireless-data cards and win valuable business customers from rival operators. But its model may point the way for other mobile operators.



Just as fixed-line operators have switched to flat-rate billing plans, mobile operators could offer unlimited national voice calls plus unlimited data for a fixed fee, so there would be less incentive to use VoIP instead. Some operators are already moving that way, and unlimited-use data plans are also growing in popularity. Vodafone's Mr Sarin says he is watching the technology closely. But it need not be bad news for his company, he insists, because to make mobile VoIP calls subscribers will still need to pay for access to a high-speed wireless network, which is exactly what mobile operators provide.

Indeed, operators might embrace mobile VoIP technology themselves, as the cheapest way to offer unlimited calls. A recent report by Analysys, a consultancy, predicts that mobile VoIP will account for 25% of mobile calls in Europe and America by 2015—but that this will actually be a good thing for operators. They will offer mobile VoIP as a premium service with additional features such as instant messaging and “presence” information. At the same time mobile VoIP will reduce costs for operators, just as it has done for fixed-line operators, the report predicts.

Voice-data convergence, then, seems likely to mean that in future customers will pay a monthly access fee to use their phones but not pay for individual calls. Geographical and time-based charging will pass into history as VoIP erases the distinction between voice and data. This will happen on both fixed and mobile phones—though convergence is starting to erase that distinction, too.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Home and away

Oct 12th 2006
From The Economist print edition

After many false starts, fixed and mobile phones are getting ready to merge

PITY the poor old fixed-line telephone. Not only is it now being hollowed out by VoIP technology; it has also been upstaged in recent years by the mobile phone, a far more glamorous, capable and personal device. The fixed-line phone looks old-fashioned by comparison. Where is the colour screen, the camera, the funky ringtone? What, no text messaging? No wonder mobiles now outnumber fixed phones, and that voice traffic is migrating from fixed to mobile networks. Some people are even "cutting the cord"—ditching fixed lines altogether in favour of mobile phones. The proportion of "mobile-only" households is approaching 10% in America, around 15% in western Europe and over 35% in Finland.

But fixed-line phones do have some things going for them. Calls are cheaper and clearer, and you do not have to hunt around for a signal. So technologists have long dreamed of combining fixed and mobile phones to provide the best of both worlds: the freedom and flexibility of a mobile phone plus the reliability and low cost of fixed lines. This is called "fixed-mobile convergence" (FMC), and there have been many failed attempts at it over the years. But this time it looks as though it might really happen, thanks to improvements in technology and the industry's current mania for convergence. "FMC may finally be taking off after so many false starts and empty promises," says Mike Thelander of Signals Research Group, a consultancy.

The prospects for fixed-mobile convergence have improved because of the spread in recent years of broadband internet connections and the Wi-Fi short-range wireless networking standard, two crucial elements for FMC. Calls are handled within the home by a small base-station that plugs into a fixed-line broadband internet connection. This base-station communicates with nearby mobile phones using Wi-Fi (so you will need a new "dual mode" Wi-Fi-capable handset, to the delight of handset firms).

The home base-station pretends, in effect, to be an ordinary mobile-phone base-station. As you enter your house, your phone "roams" on to it. When you make a call, it is routed as a VoIP call over the broadband connection, which can handle several calls at once. If you leave the house while making a call, you roam seamlessly back on to the ordinary mobile network. And when a friend comes to visit, her phone roams on to your base-station, but the charges for any calls she makes appear on her bill.

For consumers, fixed-mobile convergence promises the convenience of a single handset, a single address book and a single voicemail box, plus good reception and cheaper calls when at home. "We take care of connecting you to the cheapest network, wherever you are," says Mr Lombard of France Telecom, which recently launched a fixed-mobile service called Unik. There are also benefits for businesses. Surveys by Gartner and IDC found that over half of employees' mobile-phone calls are made in the office, even

though cheaper fixed-line phones are available; 28% of workers use their mobile phones as their primary phones. Integrating fixed and mobile phones could help companies control and reduce their spending on mobile telephony. Some FMC systems, for example, allow calls from mobile phones to be routed through a company's central switchboard. This makes outgoing calls, particularly international ones, much cheaper.

Operators like the idea of FMC too. For incumbents it has several attractions, notes Mr Pileri of Telecom Italia. Primarily, he says, it provides “another reason for our customers to buy broadband access”. Next, it discourages subscribers from defecting to rival mobile operators or even giving up their landlines altogether. FMC also provides a defence against pure-play VoIP operators, who can compete with incumbent fixed-line operators on cost but cannot provide the seamless service of a single handset that also works when customers are out and about. FMC is, of course, a bundle: it ties together fixed, mobile and broadband services in a particularly “sticky” way that makes it a powerful customer-retention tool.

Fusion or confusion?

But how is FMC working out in practice? One of its strongest proponents is BT, which launched a service called Fusion last year. (It currently uses Bluetooth for the short-range indoor radio link, but will go over to Wi-Fi technology early next year.) BT sold off its own mobile network a few years ago, so it buys airtime from Vodafone. Indeed, it is the lack of a mobile network that makes BT such an enthusiastic backer of FMC, because it enables the company to re-enter the mobile market with a distinctive product that sets it apart from other operators.

However, Fusion has not been very well received. For one thing, it is quite expensive, says Paul Merry, an analyst at Informa, because customers have to have both a standard fixed line and broadband service from BT before they can subscribe to Fusion, which then adds its own baffling range of mobile-like calling plans on top. So to anyone who has already dumped their fixed line, switched to a cheaper fixed-line provider or does not have broadband, Fusion looks pricey. And the Bluetooth technology, which BT chose because it wanted first-mover advantage, is “the most clunky system ever”, says Mr Merry.

BT's Mr Verwaayen naturally leaps to Fusion's defence. The technology works well, he says, and by mid-2006 some 35,000 subscribers had signed up, “which I think is fantastic” (though given that BT has over 20m residential customers, it seems a modest number).

Even so, Mr Verwaayen admits that what customers like most about Fusion is the rather prosaic benefit of good indoor mobile coverage, so that their mobile phones work properly even if they live in an area with poor network coverage. “I thought they would be wowed by technology,” he says, “but consumers have their own logic.” The lack of enthusiasm for FMC is not surprising, says Mr Thelander, because most of the benefits accrue to operators. “These services are offered by operators to increase their revenue and reduce customer churn with very little in it for consumers,” he says.

Another criticism of today's FMC systems, including Fusion and Unico, is that customers still retain both their fixed and mobile numbers (though France Telecom's Unik service uses just the mobile number). BT argues that Fusion is not designed to do away with the fixed-line phone, but to enhance the mobile phone—a natural position for a fixed-line incumbent to take.

But regulation is also a factor in some markets. In South Korea the OnePhone service launched in 2004 by KT, the local incumbent, has been hobbled by regulators' refusal to allow discounted tariffs, as well as by poor sound quality and the lack of seamless roaming between indoor and cellular networks. Mr Pileri says that in Italy regulatory constraints prevent Telecom Italia from offering Unico with a single number. Regulators also prohibited fixed-mobile convergence in Japan, arguing that nobody else would be able to match the combination of NTT, the fixed-line incumbent, and its dominant mobile arm, NTT DoCoMo. But the rules are being relaxed. Now that Softbank, an aggressive broadband provider, has acquired Vodafone's Japanese mobile unit, it too will be able to offer fixed-mobile convergence.

Give me convergence, but not yet

In short, the fact that fixed-mobile convergence is at last technically feasible does not guarantee its rapid adoption. There does not seem to be all that much in it for consumers. It will probably happen eventually, so that the handset in your pocket merrily roams on to whatever network allows you to make the cheapest calls, whether in the home, the office, outdoors or at the airport. And operators are already behaving as though it is inevitable: a survey by Informa found that nearly two-thirds of those who were in a position to provide FMC had begun to do so.

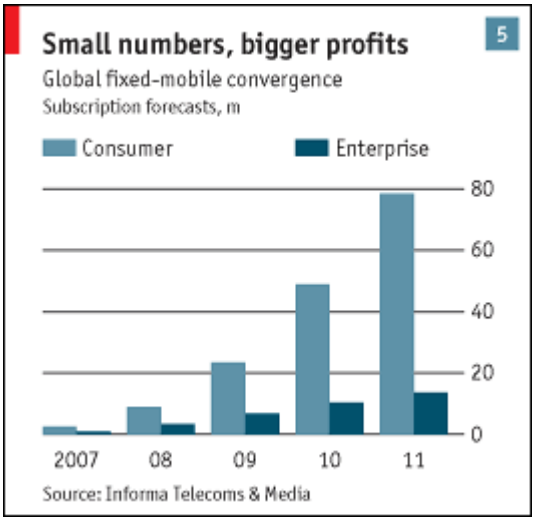
But widespread adoption of FMC will take time, says Mr Merry, because it requires technologies and business models to be brought into a new alignment. Indeed, it requires financial engineering as well as the technological kind: operators around the world will need to reabsorb their separate mobile units in order to integrate them with their fixed-line operations. (France Telecom and Telecom Italia have both done so already, though Telecom Italia now plans to reverse the process for financial reasons of its own.) That would mean, in particular, NTT absorbing DoCoMo, and Verizon buying out Vodafone's 45% stake in Verizon Wireless.

Furthermore, notes Mr Thelander, so far the only mobile handsets with Wi-Fi support are high-end models. Until Wi-Fi support is available in cheap, mainstream handsets, its appeal will be limited. Informa predicts that even in five years' time only 5% of handsets sold will support Wi-Fi. So FMC users are likely to account for a tiny proportion of telephone subscribers and revenues for the foreseeable future. “FMC's share of total communications revenues will be small for several years, but this is just the start,” says Mr Merry. He predicts a total of 92m FMC subscribers by 2011, accounting for 3% of mobile subscribers by that time.

But the prospects for FMC could improve dramatically once new “femtocell” technology arrives, probably late in 2007. This involves using an extremely small but fully fledged mobile base-station rather than Wi-Fi in the home or office. It still plugs into a broadband connection to route calls, but can be used with existing mobile handsets, which gets round the need for expensive dual-mode handsets. Softbank in Japan is particularly keen on this, as are incumbent operators in France, Germany and Italy. The problem is that femtocells are far more expensive than Wi-Fi base-stations, so everyone is waiting for the price to fall below €100, says Rupert Baines of picoChip, a chipmaker that hopes to sell its femtocell chips to established equipment-makers. That will probably not happen until 2008, but some operators may well launch femtocell-based FMC services in late 2007 in order to steal a march on their rivals.

Another factor that will influence the adoption of FMC will be the attitude of mobile operators that lack fixed-line networks, such as Vodafone. For the time being, such operators are responding by launching “homezone” products that offer consumers most of the benefits of FMC for much less hassle. Such schemes allow subscribers to nominate a particular location (ie, a particular network cell) as their home. Within that cell, their outgoing calls are charged at a lower rate. This helps mobile operators lure voice traffic away from fixed-line operators, a process known as “fixed-mobile substitution”. What mobile operators are now doing, says Mr Merry, is sticking with fixed-mobile substitution for as long as possible, to steal as much traffic from fixed operators as possible, before launching their own FMC approach.

One way of achieving that would be to buy an internet-service provider that already sells broadband access. Vodafone, for example, has recently taken control of Arcor, a German broadband provider, and established fixed-line broadband partnerships with BT in Britain and Fastweb in Italy to enable it to experiment with FMC in both countries in case the idea takes off. Similarly, O_2, an operator with mobile networks in several European countries that was acquired last year by Telefónica of Spain, recently bought a small British broadband company called Be in order to gain access to Britain's fixed-line market. Mobile operators could then use fixed broadband pipes to deliver content (such as music tracks) to mobile phones. Downloading music over wireless networks is still a painfully slow business, even with 3G mobile networks. But consumers might download more music, ringtones and games on to their mobile handsets if it was quicker and cheaper at home.



Let's get down to business

For the time being, though, FMC's brightest prospects are in the corporate market, where it can help to cut costs. Compared with the consumer market the numbers are small (see chart 5), but each customer is much more valuable. “We really see it taking off in the enterprise environment,” says Mr Merry. Informa forecasts that by 2011 business users will account for a mere 10-15% of FMC subscriptions but as much as 20-27% of FMC revenues.

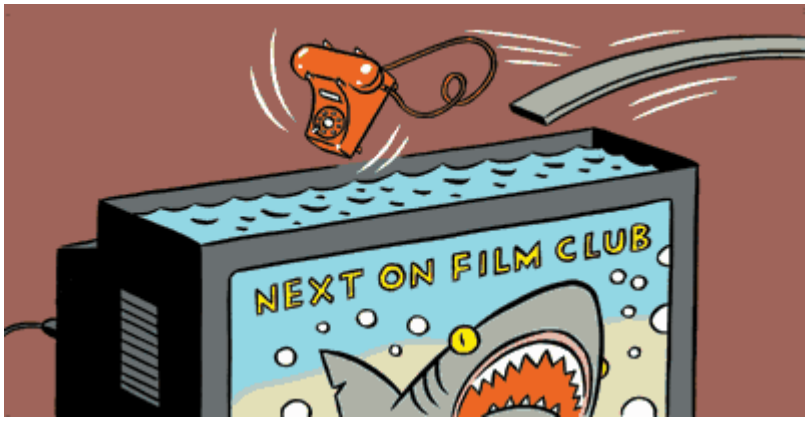
For fixed-line operators, FMC is something of a life-raft. With the traditional voice business in decline, it enables them to hold on to their customers as they try to minimise their losses from voice-data convergence. Fortunately another form of convergence—between telecoms and television—offers them the prospect of a new market and new revenues.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Tuning in to the future?

Oct 12th 2006
From The Economist print edition



Telecoms firms are moving into television, but it may not be a licence to print money

IT IS a little after nine o'clock in the morning in Grapevine, a leafy suburb of Dallas, Texas, and Thomas Hixon, a Verizon engineer, is hard at work installing equipment outside a customer's house. This is one of the neighbourhoods where Verizon, America's second-largest telecoms firm, has laid fibre-optic cable under the streets as part of an $18 billion network-construction programme. By 2011 its cables will pass 18m American homes.

A directional boring machine has already drilled a tiny underground tunnel under the driveway, allowing a final length of fibre to be run from the neighbourhood splice-box to the customer's house. This single fibre can support multiple phone lines, 60-megabit-per-second internet access and over 400 television channels, with plenty of capacity to spare.

By lunchtime, Mr Hixon has finished installing everything. The phones are working, the broadband is running and he is demonstrating how to work the digital-video recorder (DVR), which allows programmes to be paused, rewound and recorded. Robert Blalock, the newest customer for Verizon's new FiOS network, is grinning broadly. Buying phone, broadband and television service together gives him a discount of $30 a month and a single bill, easier than three separate ones.

Verizon's FiOS project is one of the most ambitious examples of how telecoms operators around the world are moving into television services, in direct response to the march of cable operators into the voice market. The snag from the telecoms firms' point of view is that whereas it costs very little to provide voice services over an existing cable network, it is very expensive to upgrade telecoms networks to deliver television over broadband internet connections, a technology generally referred to as internet-protocol TV (IPTV).

With its FiOS project, Verizon is one of a handful of operators around the world to have taken the most expensive route of all, “fibre to the premises” (FTTP), ie, running fibre right up to customers' homes. The others are NTT and SoftBank in Japan, KT in South Korea, and operators in parts of Sweden, Italy, Denmark and a few other countries. The cost involved has weighed on Verizon's share price, and its credit rating has been downgraded. “The market is very sceptical of FiOS spending,” according to Blake Bath, an analyst at Lehmann Brothers, earlier this year.

But the service seems to be proving popular: in Keller, Texas, the first suburb where the fibre network was rolled out, over 35% of homes have already subscribed to FiOS TV, and over 40% to the broadband service. This bodes well for Verizon's plan to achieve 35-40% market penetration for broadband and 20-25% for TV in the areas covered by its new network, which already includes parts of Texas, Virginia and Florida.

Sheila Lau, president of Verizon's operations in Texas, says the take-up of the “triple-play” bundle of voice, broadband and television over FiOS is nearly 80% of those taking FiOS at all. The average revenue per user, a key industry measure, is growing, and in every area where FiOS is available Verizon has been able to reduce the rate at which it is losing voice subscribers; in some areas, it is even adding some.

I want my IPTV

But for the ultimate example of an incumbent telecoms firm moving into TV, you have to visit Hong Kong. When PCCW, the local phone company, launched a TV-over-broadband service in September 2003, everyone laughed; it had tried similar ventures twice before, in 1996 and 2000, and had failed on both occasions. But its new service, Now Broadband TV, proved a success. Today it has more than 40% of the market and is on course to displace the local cable operator as the main provider of pay-TV in Hong Kong.

Moreover, last year PCCW became one of the first incumbent operators worldwide to arrest the decline in fixed-line subscribers. This is the kind of success that other telecoms firms dream of: a new service that not only stops line loss, but beats the cable companies at their own game and brings in new revenue. Better still, the service is expected to become profitable by the end of the year. No wonder that “just about every phone company in the world” has come to visit PCCW, says Alexander Arena, the firm's finance chief. PCCW is now advising telecoms firms in several countries about how to emulate its successful roll-out of IPTV.

PCCW's success provides a glimpse of the future in a technical sense as well, because it is based not on “fibre to the premises” but on a less expensive method called “fibre to the node” (FTTN) that is being adopted by many other telecoms firms. This involves running fibre to local exchanges and neighbourhood junction boxes and then, for the final link into the home, using the existing copper phone line, supercharged by a particularly fast form of the “digital subscriber line” (DSL) technology that turns phone wires into broadband pipes.

In this model, television signals travel as streams of IP packets, but because the final broadband link has a limited capacity, it is not possible to pipe hundreds of channels into the home at once and switch between them at the set-top box, as happens with cable and all-fibre networks. Only the channel that is actually being watched is sent from the fibre network down the broadband link. This has the benefit of reducing piracy and providing a far more interactive service, because individual video streams are sent to each subscriber.

Cheap and cheerful

The main advantage of FTTN is that it is comparatively cheap. Mr Bath estimates the eventual cost of connecting each home at $500-600 for Verizon, which is using FTTP, but only $250-300 for AT&T, which is using FTTN as the basis for its new network-upgrade project, known as Lightspeed. Verizon claims that its all-fibre method, although more expensive, is more future-proof; company officials say that FTTN will not, for example, support multiple high-definition streams, which require far more capacity than a copper broadband link can provide.

AT&T maintains that its system will be able to deliver two high-definition streams to each household by the end of next year. Ernie Carey, AT&T's head of network planning, insists that its more interactive approach does more than simply replicate the cable model. “We didn't just want to have a me-too product,” he says. AT&T's IPTV service, launched this summer under the name U-verse, is impressive, with lightning-fast channel changes, picture-in-picture browsing of other channels and an elegant movies-on-demand service.

As well as FTTP and FTTN, there are other ways for telecoms operators to get into the television market. When the threat from cable operators first emerged a few years ago, many operators struck resale deals with satellite-TV firms, which was a quick and easy way to add TV to their service bundles without having to build any new infrastructure. But simply bolting on TV service in this way is clunky. Hence AT&T's new Homezone service, launched during the summer, which allows it to offer an advanced television service in areas where it has not upgraded its network to support U-verse.

Homezone is based on a set-top box that contains a satellite receiver and DVR and also plugs into a

fixed-line broadband link. (The satellite content comes from EchoStar's DISH service.) The integration of the broadband connection allows it to offer interactive services such as music and film downloads. Because of the relatively slow speed of the broadband link, film downloads take place in the background, using a “queue and view” model.

An even more conservative approach to television is being taken by BT in Britain, Telefónica in Spain, Telecom Italia in Italy and KPN in the Netherlands. It involves a standard digital-terrestrial television (DTT) set-top box, capable of picking up multichannel digital TV, with a broadband connection that can be used to deliver IPTV services via the fixed-line network. This enables operators to offer music videos and films on demand, as well as a “catch-up TV” service so that customers can call up programmes they missed. It has the advantage that the basic television service can be provided without the need for any investment. The operator gets involved only in delivering the premium services, such as video-on-demand. BT's Mr Verwaayen says he does not see the point in investing billions just to replicate what cable companies can already offer.

There is no doubt that telecoms firms are technically capable of launching television services; the question is whether they will make any money out of them. “Every single customer I talk to knows the traditional voice service is being dissipated by mobile, by VoIP services,” says Nortel's Mr Carbone. “They see revenue loss, and just taking cost out of their network will not increase revenue.”

Nortel and other equipment-makers claim that there are fortunes waiting to be made by telecoms operators who jump into television. For an incumbent operator in a typical North American city, Nortel claims, a triple-play bundle including television service “doubles the average revenue per user”, thanks to new television revenues and increased uptake of broadband. Television is now the largest growth opportunity for telecoms firms, the company says, and “will dominate all aspects of a telco's business for the next five to ten years.” Alcatel, its larger rival, predicts that there will be 72m subscribers to telecoms firms' TV services by 2010, up from about 5m this year, and claims that operators can charge subscribers up to twice as much by adding television to their bundles.

Exactly what makes IPTV so compelling is hard to explain, says Alcatel's Mr Alwan. He draws an analogy with the TiVo and other DVRs. On paper, they do not sound life-changing: why would you want to pause or rewind live television, and what difference does it make being able to record programmes at the touch of a button? But in practice DVRs have changed the way many people watch television, by allowing them to ignore the schedules and call up their favourite shows in a jiffy.

Keeping up with the neighbours

Similarly, says Mr Alwan, users get very attached to IPTV features such as video on demand, being able to pause a film downstairs and watching the rest of it upstairs on a different set, or searching for programmes featuring a particular actor. “If your neighbour has a TV service where they can watch any show, anytime, without having to think about recording it, how much is that worth?” he asks. “If your neighbour has it, you will want it. It's a very interesting competitive advantage.” Hochen Tan, the chairman of CHT, Taiwan's telecoms incumbent, talks of using IPTV to deliver “e-learning, or banking, or karaoke, which traditional cable service cannot provide”.

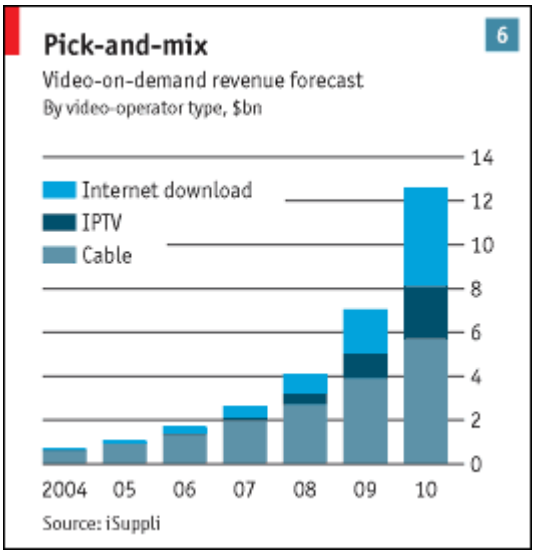
But Lars Godell, an analyst at Forrester, is sceptical. Vendors' claims for the take-up of IPTV services are implausible, he says; despite a few small success stories, such as Hong Kong, there are still no really large-scale deployments to point at. To him, the claim that IPTV will capture 30% of television subscribers within five years of deployment seems over-optimistic: 10-15% is more like it, he says. And even if television does double the operators' average revenue per user, they will not be able to pocket all of the extra money, because the content providers will need to be paid.

The problem for operators is that although many of them are not convinced by these numbers either, they still feel that they have to get into the television market anyway, because everybody else is doing it. “You have to defend yourself on as many fronts as possible, but as a strategic move to make a lot more money I don't see the justification,” says Mr Godell.

After all, video services, like voice services, can be delivered over broadband pipes by other companies too. At the moment, real-time multichannel television is too bandwidth-intensive to be provided by third parties across the internet. But downloads of individual television programmes and films are already available from MovieLink, Amazon, Apple and others. As viewers move away from traditional forms of television and towards a pick-and-mix model, telecoms firms could find themselves in a situation similar

to that created by VoIP in the voice market: their customers will be able to buy broadband internet access from one company and then choose from a host of internet-based firms for their video content. Indeed, iSuppli, a market-research firm, predicts that such downloads will be worth twice as much as IPTV video on demand by 2010 (see chart).

Telecoms operators are jumping into television at a risky time, in other words, just as the way in which it is consumed and delivered is changing radically. Perhaps they will benefit from this by offering their own video-on-demand services; but they could also find that the market is far less lucrative than they had expected.



Mr Godell believes that the best way to enter the television market, particularly in western Europe, where people are not prepared to pay very much for television content, is to keep capital expenditure and operational risk to a minimum, which would favour the hybrid DTT/IPTV approach. The projections of future growth in television adoption, says Mr Godell, ignore the fact that overall household spending on entertainment is flat, "so it's mostly about substitution—there is no overall growth."

Furthermore, Europeans spend much less on pay-TV services and DVD sales and rentals than they do on fixed-line telephony, so even if telecoms operators capture the entire television market, they will not be able to make up for the decline in their traditional voice business. They should move into television as a defence, not as a source of future growth.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Changing the rules

Oct 12th 2006
From The Economist print edition

How should regulators respond to convergence?

CONVERGENCE is forcing changes not only on telecoms companies and consumers but on regulators too. In many countries communications, broadcasting, entertainment and information services have separate regulators or different rules, but as the distinction between them starts to blur that no longer makes much sense. Drawing up new rules for a converged world, however, is fraught with pitfalls, as a recent OECD report explains. Already, fights have broken out in many parts of the world over the regulation of converged networks and bundled services.

One controversial question is whether incumbent operators should be compelled to share their next-generation networks with rivals, as they are required to do with their existing networks in many parts of the world. In America, where cable networks pass 95% of homes, regulators have decided that Verizon and AT&T do not have to make their new high-speed networks available to rivals on a wholesale basis; instead, their principal competition will come from cable operators. In Britain, however, where cable networks pass only 50% of homes, the regulator has ruled that BT must open its next-generation network to rivals. The European Commission, which published a draft of its new Europe-wide telecoms-regulation framework in June, would like to see a similar approach adopted across Europe. In August the commission ordered Deutsche Telekom to open its new network to rivals.

Bundling services together, and creating new converged services such as fixed-mobile telephony, can also raise antitrust concerns. Italy's regulator, AGCOM, imposed strict limits on the initial roll-out of Telecom Italia's fixed-mobile service, Unico, because Telecom Italia's biggest fixed-line competitor, Fastweb, could not offer mobile services, and its biggest mobile competitor, Vodafone, could not offer fixed-line services—though Vodafone and Fastweb have since struck a deal to bundle their services together. Given its dominant position in both markets, Telecom Italia was deemed to be acting anticompetitively by combining the two. Similar rules have prevented KT in South Korea from offering full fixed-mobile convergence.

In some cases special rules prevent firms that are dominant in one market from entering another at all. Japan's incumbent operator, NTT, is not allowed to enter the broadcasting market; conversely, the country's public broadcaster, NHK, is not allowed to enter the telecoms market. Similar rules preventing BT, Britain's incumbent operator, from providing entertainment services were abolished a few years ago, opening the way for the launch of its television service this year.

In America the launch of television services by telecoms firms has been held back by complicated rules that require operators to win approval from thousands of local franchising authorities. This has prompted some states to pass laws granting blanket approval for telecoms firms to launch television services, and the industry is now pressing for federal rules to cover the whole country. But cable operators are understandably opposed. They grumble that their franchises require them to offer blanket coverage, whereas telecoms firms are able to pick and choose which neighbourhoods they cover with their new television services.

Unfair advantage

Another bone of contention is “must carry” rules that require cable operators to carry certain local or public-interest channels on their networks, but do not apply to telecoms firms. The cable companies complain that having to carry these channels prevents them from using the network capacity for other things, such as internet access or new high-definition channels.

One way of dealing with problems of this kind is, appropriately enough, to establish a “converged” regulator, as Britain did when it merged its communications and broadcasting watchdogs into a single body, Ofcom, in 2003. Three years on, its experience provides three lessons for regulators in other countries, says Peter Phillips, an Ofcom strategist.

First, converged services and existing services will co-exist for a long time, “so you can't just jump straight to a solution.” Instead, regulators must be flexible enough to deal with both the old ways of doing things and the new.

Second, under the old rules there were a lot of implicit deals: telecoms operators were granted monopolies in return for providing universal service, for example, and broadcasters were given spectrum in return for meeting public-service requirements. “In a converged world, those deals need to become much more explicit if you want to preserve the policy goals,” says Mr Phillips.

Third, content on different platforms may require different rules. Broadcast television is not the same as subscription cable channels or streaming internet video. The shift away from broadcast television does require a more laissez-faire approach from regulators, but that is not the same as a total free-for-all. “If you have massive amounts of content out there, on platforms that may not respect international boundaries, you have to put more reliance on people's ability to understand the nature of content and decide how they want to engage with it,” says Mr Phillips.

That raises another regulatory challenge: the fact that different rules apply in different countries. For example, there has been a huge fuss in Europe in recent months over the extension of the European Commission's “Television Without Frontiers” directive to cover video sent over the internet or to mobile phones. The aim is to impose standards governing things like decency and advertising on these new forms of video, but critics regard the rules as too heavy-handed.

Convergence will make the need for a common set of European rules more pressing as operators begin, for the first time, to venture onto each other's home turfs. For example, Orange, France Telecom's wireless arm, operates in several European countries and now also offers fixed-line broadband and voice services in several of them in order to provide a service bundle. Similarly, O_2, another European wireless operator, is branching out into fixed-line services in several countries. Telecom Italia has launched fixed-line triple-play services in both France and Germany, and Deutsche Telekom is doing so in France and Spain.

In America, meanwhile, the debate about telecoms regulation in recent months has been dominated by one issue: network neutrality. In essence, this means that the internet simply delivers packets of information from one place to another, regardless of their content or the identity of the sender or receiver. The furore began last November, when Mr Whitacre, the boss of AT&T, complained in an interview with *Business Week* about Google, Yahoo! and other internet companies getting a free ride on his company's expensive new broadband network. “Now what they would like to do is use my pipes free, but I ain't going to let them do that, because we have spent this capital and we have to have a return on it,” he said. “So there's going to have to be some mechanism for these people who use these pipes to pay for the portion they're using.”

Neutral tones

A few weeks later Ivan Seidenberg, the boss of Verizon, said that Google, Microsoft and other providers of bandwidth-intensive internet applications ought to “share the cost” of operating high-speed networks. “We need to pay for the pipe,” he told an audience at the Consumer Electronics Show in Las Vegas. Both AT&T and Verizon denied that they planned to act as gatekeepers, blocking access to any big sites that failed to pay up. Instead, they suggested, Google and other firms, such as music and video download services, might choose to pay extra to have their traffic prioritised.

The result was an outcry. Critics felt that AT&T and Verizon were threatening to abandon the hallowed principle of network neutrality. It is this principle that has enabled the internet to support new applications and made it such a hotbed of innovation. Its agnostic design, which ensures that it blindly does its best to deliver whatever traffic is fed into it, meant there was no need for the inventors of the web, or Napster, or Skype, to ask permission to run their software across the internet.

Advocates of net neutrality gave warning that the introduction of fast lanes and other premium services could undermine this innovative culture. “If the fast lane is the information ‘superhighway', the slow lane will operate more like a dirt road,” wrote Meg Whitman, the boss of eBay, the leading internet auction site, in an e-mail to its users. “A two-lane system will restrict innovation because start-ups and small companies—the companies that can't afford the high fees—will be unable to succeed.” Eric Schmidt, the boss of Google, took a similar stance: “Creativity, innovation and a free and open marketplace are all at stake in this fight,” he said.

Such self-styled defenders of the internet like to portray the net-neutrality debate as a fight to stop evil telecoms firms messing with freedom and innovation. The reality is rather more complicated. For a start, the internet is not, in fact, neutral today. Fast broadband connections already cost more than slower ones, for consumers and businesses alike. As well as buying fast pipes and building huge “server farms”, big companies such as Google and eBay also pay extra for specialist “content delivery” services, such as Akamai, to make their websites download even faster. None of this has hampered innovation or hurt small companies.

It is also rather odd to see internet activists, who are generally suspicious of government intervention, calling for regulators to step in and pass new laws in the name of freedom. Laws mandating net neutrality could, in fact, do a great deal of harm. Ensuring “neutrality” could require regulators to interpose themselves in all kinds of agreements between network operators, content providers and consumers. Content-delivery services, such as Akamai's, might suddenly become illegal. Strict rules could also hinder the development of new services that depend on being able to distinguish between different types of traffic. And it does make sense, after all, to be able to prioritise telephony and video traffic over e-mails. “We are talking about some people getting a better service if they are prepared to pay for it,” says Forrester's Mr Godell.

By dressing up the net-neutrality debate as a fight for online freedom, however, Google, eBay and other big internet firms have cleverly diverted attention from an unpleasant truth. As telecoms firms around the world upgrade their networks, there are two ways in which they can recoup the money. They can simply charge subscribers more; or they can pursue new business models in which big internet firms and other content-providers pick up some of the bill too.

But the idea that big firms such as Google ought to contribute in some way to these costs “has been roundly greeted as if it is a threat to basic liberties,” notes Craig Moffett, an analyst at Sanford Bernstein in New York. Despite their howls at the idea of paying for such services as packet prioritisation, he says, it would in fact be the big internet companies that would benefit most from the new business models that such premium services might unlock.

In the name of consumer choice

That does not mean that big telecoms firms should be allowed to interfere with access to sites that do not pay them. But Mr Whitacre insists that he has no plans to do so. “We're not going to block, we're not going to interfere with what's out there today,” he says. Instead, the idea is to charge extra for additional services. “The other way, consumers are all locked into one calibre of service, but consumers should be free to choose what they want,” he explains. Not everyone believes him, of course. But so far there is no evidence that AT&T or Verizon have tried to block sites or demand ransoms. And if they do, regulators will be able to take action under existing antitrust laws—there is no need for a new net-neutrality law.

Even so, the arguments of the past few months have served a useful purpose. “The public reaction has already been as powerful and effective as any law,” says Timothy Wu, a professor at Columbia Law School who is credited with coining the term “net neutrality”. The debate has put the telecoms companies on notice that they are being watched closely, he says, and has forced them to make public pledges not to block or degrade access. “Shame can have more power than litigation,” says Mr Wu. “The market and consumers can control bad practices, but consumers actually have to be aware of what is going on for that to happen.”

The telecoms firms could even find that the boot is on the other foot, says Mr Odlyzko of the University of Minnesota. Referring to companies such as AT&T and Verizon, he asks: “What makes them think that they are going to charge Google, as opposed to Google charging them?” Cable companies, he points out, have to pay for the television shows and films they deliver over their networks.

Clearly convergence requires new or updated rules in some areas and the enforcement of existing rules in others. But overall, by pitching companies in previously distinct industries against each other, convergence will result in more vigorous competition. That should allow market forces, rather than regulators, to determine the best shape for the industry.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Winners and losers

Oct 12th 2006
From The Economist print edition

Who will benefit most from convergence?

WHO is right about convergence, the boosters or the sceptics? The truth probably lies somewhere in the middle. Operators have high hopes that convergence will open up valuable new markets, but that seems unlikely. Voice-data convergence can cut operating costs, but the same VoIP technology is also eroding revenues from traditional fixed-line telephony, and new revenues from broadband will not fill the gap. Fixed-mobile convergence may help operators to hold on to customers, but will not produce much, if anything, in the way of new revenue. And the prospects of telecoms firms making money from television also look dim, because they will have to lure customers away from other television providers and invest heavily.

Yet that is not to say that telecoms firms should keep clear of convergence. It might still be the best way for them to cut costs, fend off competitors, retain customers and minimise their losses from declining fixed-line voice revenues—not least because everyone else will be doing it. They may have overstated the money-making potential of convergence, but there are probably good reasons to pursue it anyway, not least greater operating efficiency and lower running costs.

“It's not a panacea, but it is a necessary step,” says Alcatel's Mr Alwan. “It doesn't fix everything right away—it's a multi-year, multi-step, complex project that will ultimately deliver a better infrastructure with which to lower costs and improve services.” AT&T's convergence project, Lightspeed, for example, is not being driven by a mania for technology for the sake of it, says Mr Alwan, but “because there's a serious threat to voice revenues from triple-play bundles from cable companies.”

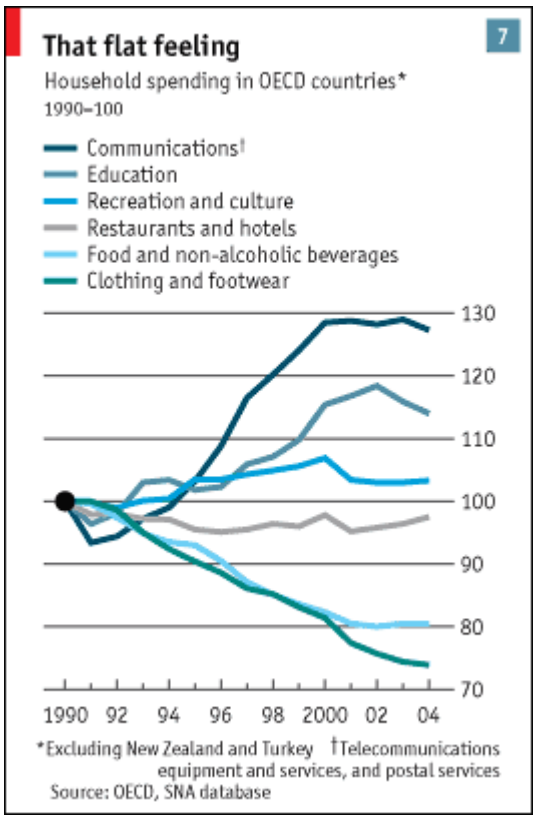
As well as cutting costs by replacing many separate networks with a single, converged one, telecoms operators will also increase their agility, suggests BT's Mr Verwaayen. Offering low-priced bundles of services will attract a certain number of customers, he says, but the real benefit of convergence is its potential to make entirely new services possible. “In the past, you could make a map of what your customers wanted going forward. But nowadays it's like the fashion business: moods change, and it's hard to predict,” he says. Convergence, he adds, is “the only way I know to be flexible and agile, so it doesn't matter if customers change their minds.” Inevitably, operators will continue to launch some services for which demand turns out to be low, but convergence should make it easier and cheaper to experiment, and thus to find new services that people actually want.

Bundle of joy

And, of course, offering bundles of converged services makes customers less likely to defect and saves money on marketing and customer acquisition, because many services can be advertised and sold together. Bundling services together also makes sense on basic economic grounds, observes Mr Odlyzko of the University of Minnesota: “It means you can exploit uneven preferences for different goods.” Demand for bundles is more predictable than demand for individual services, and customers who might not find individual services attractive may be prepared to buy the whole bundle. Bundling hides the prices of individual services, and a single bundle appeals to different customers for different reasons. This also makes bundles more profitable, because people may end up paying for services they do not want.

But everyone is doing it, and, by definition, not everyone can be more competitive, more agile and better able to attract new customers and retain existing ones. Figures from the OECD show that household spending on communications, having risen during the 1990s as people signed up for internet access and mobile phones, has been flat since 2000. The same is true of spending on recreation, which includes television, DVD sales and rentals, and cinema-ticket sales (see chart 7).

As VoIP has driven down the cost of fixed-line telephony, consumers have spent more on mobile phone calls instead, says Rupert Wood of Analysys; but their overall spending on voice calls has stayed roughly constant. So the coming fight between converged operators of various kinds will be over the allocation of existing spending. Nobody seems to be offering anything new that will increase the overall size of the pie.



Despite the evidence to the contrary, everyone seems to think they can win. “At the moment, the stockmarket valuations of both telcos and the cable companies seem to assume that each side is going to win close to 100% of the market,” says Mr Odlyzko. Something similar happened during the telecoms boom of the late 1990s: dozens of companies built identical long-haul fibre networks, each assuming that they would win 20% of the market. As a result, most of them went bust.

This time around, convergence will have the effect of intensifying competition, dividing the industry into winners and losers and leading to a round of further consolidation. So who will do best? Not simply those who embrace convergence most quickly to benefit from reduced costs and greater agility; there are other factors, too.

The first is flexibility. Not everyone wants to buy a bundle of services, so operators must allow customers to pick and choose the services they want. “We looked at many carriers across the globe, and generally speaking there is a category of customers that want a triple-play, but overall most customers preferred single-play and double-play, mixing offers from different players,” says Mr Zibi of Pyramid Research. The most successful operators, he says, are those that have the technology to offer multi-play service bundles, “but offer those services in such a way that the consumer is the one making the choice—they don't push a specific bundle, or force services on consumers that they don't necessarily want.”

Mr Barrett at Parks Associates has come to a similar conclusion. In a survey of American households with broadband, 43% said they had not subscribed to a multi-service bundle because they wanted to make specific choices for different services. Intriguingly, this suggests that there will continue to be a role for companies that specialise in particular services, such as satellite television or mobile telephony, and do not offer the entire triple-play or quadruple-play package. “The triple-play hasn't been an overwhelming success so far,” says Mr Wood. “It's driven by operators' desire for it to work, rather than real demand. So there will still be demand for single-service suppliers, and for single services from suppliers who also offer the triple-play.”

The customer is king

Crucially, to get customers to sign up for three or four services, each of those services must be

competitive and attractive in its own right, says Mr Zibi. “The beauty of convergence as we see it isn't so much that you can sell multiple services to a customer, but that you can allow them to mix and match whatever services they want,” he says. Sol Trujillo, the boss of Telstra, draws an analogy with shopping. Some people want simplicity, he says, and prefer to have everything in one place, as in a mall or a department store. But others prefer to do some shopping in the mall and to seek out specialist shops for specific products. “So you have to allow both à la carte and integrated capability,” he says.

Secondly, for convergence to work it has to be simple for the consumer. This is something that every technology firm insists is a top priority. But their products, and their users, suggest otherwise. “I'm sure if you go to some laboratories somewhere, they can show you caller ID on the TV screen. The challenge is to take the technology and make it really simple, so our mothers and fathers can use it,” says Skype's Mr Zennström. Making free phone calls over the internet has been technically feasible for years, but it only really took off with the arrival of Skype, which made it easy. “We try to make things really simple, so you don't need to be an engineer to set them up,” explains Mr Zennström.

Mr Lombard of France Telecom admits that the industry still has some way to go in this regard. The past decade, he says, has seen the introduction of all kinds of wonderful new technologies. “But we have a kind of complexity in all these products that is rather artificial and probably transitional,” he says. Carmakers do not expect drivers to open up their cars and adjust their engines. “If you compare what we are asking customers, we are asking them to enter codes, addresses, it is far too complex,” he says.

What's in it for me?

Mike Cansfield of Ovum, a telecoms consultancy, also reaches for an automotive analogy. “Telecoms has historically been technology-led, full of technobabble,” he says. “You have to be able to articulate benefits to encourage take-up.” Consider the windscreen wipers on a car: “You could talk about different motors, variable speeds and intermittent wipes, but the benefit is that you can use the car whatever the weather.” Similarly, he says, telecoms firms have to become more marketing-savvy. If they cannot explain the benefits of their whizzy new converged services, nobody will sign up for them.

There are signs that some companies have realised this. Hong Kong's Now TV, a pioneer in video-over-broadband, has developed a “network DVR” that provides TiVo-like recording and playback facilities without any extra hardware; instead, the recorded programmes reside on the network. It is all very clever, but also rather hard to explain. So the company has decided to take its time over rolling out this and other innovations to avoid overwhelming its customers.

In theory, a bundle of converged services delivered by a single operator through a single “gateway” box should be easier to use than a jumble of boxes from different companies. The operator can ensure that the user interface is logical and consistent, and that all the various services work together well. (This is a large factor in the success of Apple's iPod music-player, iTunes software and iTunes store, all of which seamlessly work together.) AT&T is tightly interlinking its various services so that, for example, pictures taken with a mobile phone can be uploaded to the user's website and can then easily be called up on the television screen; another feature allows subscribers to AT&T's Homezone service to programme their DVRs remotely via the web. But a balance must be struck between such clever new features and ease of use.

A third and final factor in making a success of convergence is a strong brand founded on good customer service—otherwise consumers will not want to sign up, even if offered discounts. This sounds obvious, but it could mean that telecoms operators have an advantage over cable companies, which have weaker brands and are generally less well regarded by consumers, says Mr Godell of Forrester. That explains why NTL, Britain's cable operator, recently took over Virgin Mobile: both to complete its quadruple-play bundle and to gain access to the stronger Virgin brand. Similarly, France Telecom rebranded itself as Orange, its mobile brand; other operators are doing the same, because their strongest and youngest brands are usually those associated with mobile telephony.

Convergence is both a response to, and a reflection of, far greater competitive pressure in the telecoms industry. “The competition could get very ugly,” says Mr Odlyzko. “But in the end consumers will be the beneficiaries.” Mr Godell agrees. “In a world where prices are falling every year, I think the only real winners are end-users,” he says. “Consumers will have an increasing array of nicely packaged services at lower prices. But it will be messy.”

Ultimately, consumers and businesses will be able to choose from a wider range of communications

services and a wider range of providers. Some will have come from the world of telecoms; some from the field of cable television; some will have started out as internet-access providers; some will be bulked-up satellite-TV firms. But they will all be fighting over the same customers. The companies involved must be prepared for a bloody battle; regulators must ensure that the fight is a fair one; and consumers, with luck, will enjoy greater choice and lower prices.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Sources and acknowledgements

Oct 12th 2006
From The Economist print edition

World Telecommunication/ICT Development Report 2006: Measuring ICT for Social and Economic Development, International Telecommunication Union, 2006.

Multiple Play: Pricing and Policy Trends, Organisation for Economic Co-operation and Development, Working Party on Telecommunication and Information Services Policies, April 2006.

United States Senate Commerce Committee Hearing on Net Neutrality, February 2006.

Organisation for Economic Co-operation and Development Telecommunications Statistics

International Telecommunication Union Telecommunications Statistics and Trends

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Offer to readers

Oct 12th 2006
From The Economist print edition

Buy a PDF of this complete survey, including all graphics, for saving or one-click printing.

Reprints

Reprints are available should you wish to order extra copies of the survey. Please send your request to the relevant region:

Worldwide (excluding North America):

Rights and Syndication Department
26 Red Lion Square
London
WC1R 4HQ
United Kingdom

Tel: +44 (0)20 7576 8000
Fax: +44 (0)20 7576 8492
E-mail: rights@economist.com

North America:

Rights and Syndication Department
111 West 57th Street
New York
NY 10019
USA

Tel: +1 212 541 0532
Fax: +1 212 641 9808
E-mail: usrights@economist.com

Corporate offers and customised reprints

For corporate reprint orders of 500 or more and customisation options, please contact the Rights and Syndication Department in the relevant region:

Worldwide (excluding North America):

Rights and Syndication Department
26 Red Lion Square
London
WC1R 4HQ
United Kingdom

Tel: +44 (0)20 7576 8000
Fax: +44 (0)20 7576 8492
E-mail: rights@economist.com

North America:

Rights and Syndication Department
111 West 57th Street
New York
NY 10019
USA

Tel: +1 212 541 0532
Fax: +1 212 641 9808
E-mail: usrights@economist.com

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Google and YouTube

Two kings get together

Oct 12th 2006 | SAN FRANCISCO
From The Economist print edition

AP

Google's acquisition of YouTube shows that "Web 2.0" has come of age

Get article background

"CHAD and Steve remind me of Larry and Sergey," said Eric Schmidt, father figure and chief executive of Google, on October 9th. Google, founded by Larry Page and Sergey Brin, was announcing its purchase, for $1.65 billion in shares, of YouTube, founded by Chad Hurley and Steve Chen. Messrs Page and Brin created an internet phenomenon with their search engine and refuted conventional wisdom by proving that search could make money when paired with advertising. During the past year Messrs Hurley and Chen (pictured) have created another phenomenon: a simple, fun website to which anybody can upload video clips in order to share them. Every day YouTube fans upload 65,000 videos and watch 100m. Admittedly, YouTube has yet to prove that advertising can make video clips as lucrative as search results. But Google, too, only found a way to "monetise" its service after it had become popular. "This really reminds me of Google just a few years ago," said Mr Brin, to drive the point home.

With this deal, "two kings have gotten together," boasted Mr Hurley in a video clip on YouTube, with his team in stitches over the grandiose language. But he was not exaggerating. The stockmarket debut in 1995 of Netscape, the first popular web browser, marked the internet's first generation. The merger of "old media" Time Warner and "new media" AOL, announced in 2000, came to symbolise that era's excesses; and the collapse in 2001 of Webvan, a notoriously hapless dotcom, epitomised the bust. This week's pairing of Google and YouTube may come to be remembered as the moment "Web 2.0"—ie, the web, version two—came of age.

Until recently, however, the deal seemed unlikely. Messrs Hurley and Chen said publicly that they were not looking for a buyer because they wanted to remain independent; privately, they had unflattering things to say about Google and its rival clip-sharing site, Google Video. For its part, Google made many small acquisitions but professed not to be interested in big ones. If anything, Messrs Page and Brin were becoming concerned that Google already dabbled in too many products beyond web search and risked confusing its users.

Both firms changed their minds. For YouTube, a sale was logical. Like the dozens of other independent video-sharing sites, it makes losses, incurs large costs from storing and delivering all those videos, and has no revenues to speak of. It is also walking a legal tightrope because many clips violate copyright.

And its investors wanted a return on their money.

A sale to Google neatly solves most of these problems. Google's vast and growing computer farms can store information more cheaply than any other firm's. Its main business of search-related advertising is so profitable that it can afford to carry YouTube until meaningful revenues appear. Google has the largest online network of advertisers, whom it can now refer to YouTube. It has armies of lawyers that can be deployed to handle copyright suits. YouTube's founders and investors will make a fortune. And Google has, apparently, even agreed to allow YouTube to maintain its separate identity.

For Google, the case for buying YouTube was less clear at first. So far, Google has bought tiny technology firms, often to annoy Microsoft, the software giant that dominated the PC era and the first generation of the web. This time, however, Google is buying a rival. According to Hitwise, a market-research firm, YouTube has four times as many visitors as Google Video; according to comScore, another research outfit, YouTube streams nine times as many clips as Google Video. That Google is now prepared to buy, rather than build, market leadership marks a big strategic change.

The deal is “an aggressive, mature move for Google, one that shows that senior management is not too proud or stubborn to see that they can't build everything themselves,” says Henry Blodget, an analyst at Cherry Hill Research. Indeed, Google's Mr Schmidt freely conceded that YouTube is the “clear winner”, especially in creating social networks around its site.

But Google also appears to be thinking a lot further into the future. Its mission is “to organise the world's information,” and a lot of information happens to be in video form. Google's natural impulse is to unleash its algorithms on this video content in order to search it. But direct searching of pictures or videos (as opposed to the words that people attach to describe them) is much harder than indexing and searching text. “Video search simply doesn't work,” says Charlene Li, an analyst at Forrester, a research firm, so users have to “rely on the opinions, ratings, and playlist compilations of others to discover good video.” That means using social networks—precisely YouTube's approach.

Together, Google and YouTube can also better address the single biggest risk to both of them: lawsuits. “Google lawyers will be a busy, busy bunch,” says Mark Cuban, a blogger and billionaire since he sold Broadcast.com, a web-radio firm, to Yahoo!, Google's main rival as a portal site, in 1999. YouTube reminds him of the early days of Napster, an internet service that let users share pirated music. Like YouTube today, says Mr Cuban, Napster said it would remove pirated material at the request of any copyright owner, thus seeking refuge in the “safe harbour” clause of a 1998 copyright law. But Napster lost in court and ceased to exist in its original form.

A combination of Google and YouTube may help in two ways. First, the two companies are such a force in web video that they ought to be able to strike partnership deals with copyright owners who might otherwise sue them. Hours before they made their deal public, both Google and YouTube announced separate deals with music studios and media companies that will make them, in effect, distribution channels for those content owners. Second, YouTube has been working hard on “fingerprinting” technologies that would allow content owners to trace their property as it migrates around the web and to share any advertising revenues it produces. But YouTube has not got very far. “Who is in a better position to develop that technology—60 burnt-out people at YouTube or the legendary technical minds at Google?” asks Forrester's Ms Li.

The main benefit of the deal, however, may be the difficulties it creates for Google's rivals. Yahoo! and Microsoft, as well as News Corporation and Viacom, two media giants, all wanted YouTube. But Google pre-empted them, just as it denied them access to AOL, another portal, in which it bought a defensive stake last winter. Microsoft now claims that it has decided to build its own video-sharing business. But this misses the point: YouTube's value to Google is not its technology, but its audience and its brand, which no amount of clever programming can duplicate. Meanwhile Yahoo!, which has already lost out on several other big deals, will now have to offer ever more desperate prices for Facebook, a social-networking site it is said to be interested in buying. Google's lead looks bigger than ever.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com BUSINESS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

European television

Regulation without frontiers

Oct 12th 2006
From The Economist print edition

The EU's proposed rules for internet video are out of tune with the times

TELEVISION used to be simple: you turned on, tuned in, and dropped off. Only a small handful of stations existed, because spectrum was scarce. In return for government licences, broadcasters were heavily regulated. But technology has changed everything. Cable and satellite deliver hundreds of channels; broadband links and sites such as YouTube allow anyone to distribute video to millions of people; and mobile phones will soon let people watch television anywhere. Everything has changed, in short, except the regulations. Europe's attempt to update the rules, however, has become highly controversial.

In November the European Parliament's culture and education committee is due to move forward on its proposed “audiovisual media services” directive, before sending it to the full parliament in December. The new rules update and relax the “Television Without Frontiers” directive of 1989, which opened Europe's national markets. But critics complain that they also seek to extend fusty regulations from the era of broadcast television to today's very different technologies. Rules on advertising, national production quotas, the protection of children and so on could potentially also apply to all kinds of video streams, including video blogs, online games and mobile-video services.

This could have a chilling effect on innovation and risks stifling nascent technologies with rules designed for another age, says Chris Marsden of RAND Europe, a think-tank that has analysed the potential impact of the proposed rules for Ofcom, Britain's media and telecoms regulator. “Regulators have to be thoughtful. They cannot predict the future of television or the internet—no one can,” says Niklas Zennström, a co-founder of Skype, who is now setting up an internet-television firm.

The proposed rules may be unrealistic as well as onerous. The idea that websites can be regulated like broadcasters, which are required to keep strict records of what they show in order to help watchdogs investigate complaints, is untenable. Firms could simply relocate outside the European Union to escape the new rules. Last week Ruth Hieronymi, a member of parliament, said she would introduce wording that might help to overcome some of the objections.

Behind the debate is the question of how best to balance competition and protection. Traditional broadcasters worry that they will be shackled by regulations while nimble start-ups can do as they please—so they like the idea of extending regulation to their new rivals. But even if the rules are approved as they stand, they will not come into force until 2010. Such a long, slow process seems incongruous given the pace of technological change.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com BUSINESS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Airbus

In place of Streiff

Oct 12th 2006 | LONDON AND PARIS
From The Economist print edition

Louis Gallois takes over as boss of Airbus, but the dollar problem remains

CHRISTIAN STREIFF didn't go quietly. After handing in his resignation as boss of Airbus, the ailing European aircraft manufacturer, on October 9th, Mr Streiff gave lengthy explanations about the reasons for his departure after only 100 days in the job. The governance at the European Aeronautic Defence and Space (EADS) company, Airbus's parent, would not allow his plans to succeed, he said, because its main objective is to keep the balance of power dictated by the company's Franco-German shareholder structure.

EADS is relieved to see Mr Streiff go, implying that he did not have the diplomatic skills to work with its German and French factions. EADS has always had French and German co-chairmen and co-chief executives, because French shareholders own 25% of the firm (the government has 17.5% and the Lagardère conglomerate has the rest) and Germany's DaimlerChrysler has another 22.5%. Louis Gallois, one of the co-chief executives, was made boss of Airbus, reporting to the main board. This hugely simplifies the chain of command.

On October 10th Mr Gallois travelled to Airbus's final assembly plant in Toulouse to reassure union leaders and local politicians. But he admitted that he intended to stick to Mr Streiff's radical restructuring project. The so-called “Power8” plan was announced last week after EADS admitted that the increase of the delay to the production of the A380 passenger jet to two years will knock a further €4.8 billion ($6 billion) off profits at EADS between 2006 and 2010. The plan aims to save €2.1 billion a year by 2010.

The details of Power8 will be made public only early next year, but the plan is likely to involve considerable job cuts in France and Germany as well as the sale or closure of production sites. Politicians in both countries are on their soapboxes howling about job losses and calling for the repayment of subsidies that EADS received from local governments. The German press is reporting rumours of plans to sack 6,600 workers and shut five factories in Germany, which Airbus denies.

Mr Gallois is well qualified to tackle the trickiest job of his career. Before taking over as co-chief executive of EADS earlier this year he was boss for ten years at SNCF, the French state-owned railway firm. He gained a reputation as a skilled negotiator with unions, pushing through painful changes without much labour unrest. He knows the aerospace industry well, having run Snecma, a maker of aero-engines, and then Aérospatiale, the French firm that was merged into EADS in 1999. Ironically, BAE Systems, which has just sold its 20% stake in Airbus, had been trying for years to get Mr Gallois brought in to run Airbus, but the French government wanted him to stay running the railways.

Despite the widespread panic caused by the latest A380 delays, Airbus's problem is not its dispersed manufacturing set-up per se. Its real headache, given that most of its costs are in euros and its sales in dollars, is coping with a 30% drop of the dollar against the euro in recent years. If distributed manufacturing and snap-together assembly were really such bad ideas, its American rival Boeing would not have recently adopted the same approach, flying in sub-assemblies to its Seattle base from as far away as Japan and Italy. Boeing has also outsourced some work in Kansas, after selling one of its main factories to a Canadian private-equity firm, from which it buys fuselage sections at lower cost than when it owned the factory.

It will not be so easy for Mr Gallois to pull off the same trick, since it implies lower wages for the workers under new owners. David Pritchard, an American academic and consultant who has studied both companies, says that Airbus must now send more basic work to cheap-labour countries in Asia with currencies tied to the dollar, keeping only high-added-value stuff and final assembly in Europe.

Besides making production changes, Mr Gallois also needs to convince the board of EADS to approve the development of a new, extra-wide-bodied aircraft called the A350XWB. This will cost almost €10 billion but the plane, a rival to Boeing's 787 Dreamliner, is central to Airbus's plans to catch up with its arch-rival. Mr Gallois may also be obliged to find someone to fill another tricky job at Airbus. Rumours say that Gerhard Puttfarcken, boss of Airbus Deutschland, is on his way out. Mr Puttfarcken oversees Airbus's production site in Hamburg, which is responsible for the problem with the wiring of the rear fuselages of the A380 that caused the damaging delivery delays.

Mr Streiff made himself especially unpopular when he said it would take 15 years to get Airbus back on track. It was the last thing a demoralised workforce wanted to hear. Mr Gallois hopes it won't take quite so long. Much will depend on his skills as both manager and diplomat.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

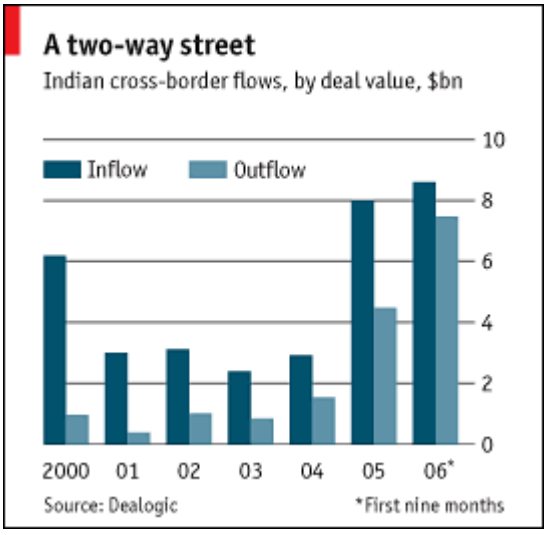
India's acquisition spree

Circle the wagons

Oct 12th 2006 | DELHI
From The Economist print edition

The Indians are coming—to buy Western companies

INDIAN companies are in an expansive, acquisitive mood. For proof, one need look no further than the confirmation from Tata Steel, India's largest private-sector steelmaker, that it is mulling a bid for Corus, a much larger Anglo-Dutch rival. If the deal came off, it would be worth several billion dollars, by far the largest foreign purchase ever made by an Indian firm. In the first three quarters of this year Indian companies announced 115 foreign acquisitions, with a total value of $7.4 billion, a huge increase on previous years, and almost as much as foreign firms have invested in Indian purchases (see chart).



The shopping spree spans industries from information technology (IT) and outsourcing to liquor. Wipro, for example, one of the country's big three IT firms, has this year acquired technology companies in Portugal, Finland and California. In pharmaceuticals Ranbaxy, an Indian maker of generic drugs, bought Ethimed of Belgium and Mundogen, the Spanish generics arm of GlaxoSmithKline.

Bharat Forge, the world's second-biggest maker of forgings for engine and chassis components, based in the Indian city of Pune, has since 2004 bought six companies in four countries—Britain, Germany, Sweden and China. Suzlon, another Pune firm, which makes wind turbines, this year bought Hansen, a Belgian gearbox-maker. And United Breweries, a booze conglomerate from Bangalore, has made an unsolicited bid for Whyte & Mackay, a Scottish whisky distiller.

Behind this push overseas lies a combination of forces: a domestic boom; the availability of credit; a rush to achieve global scale; and a new self-confidence about Indian business's ability to add managerial value. India's economy is in its fourth successive year of growth at around 8%. In the first two quarters of this year GDP grew at rates of 9.3% and 8.9% respectively over the same periods in 2005.

Research into 127 Indian companies by Motilal Oswal, a firm of stockbrokers, forecasts that their sales will have increased by 27% in the third quarter, compared with the same period a year earlier. Profit margins are widening: net profits are predicted to have grown by 39%. This week Infosys, another IT star that is one of the first firms to report its quarterly results, actually beat these forecasts. In rupee terms its quarterly net profits had grown by 53% year-on-year. The firm, which crossed $1 billion in annual revenues only in the financial year ending in March 2004, expects to pass $3 billion in this one.

With strong balance sheets, finance is not an obstacle. The stockmarket has been booming—this week its main index was just below its historic peak. Rupee interest rates, although they have been edging upwards for the past two years, are still, in real terms, at about half their levels of a decade ago. And, despite capital controls that place limits on external borrowings, India's big companies can raise huge amounts of money abroad. In August Reliance Petroleum raised the largest-ever syndicated loan for India, of $1.5 billion. Tata Steel is reported to have secured financing commitments of $6.5 billion for its putative bid for Corus.

Going global

That an Indian firm should even be contemplating borrowing so much for an acquisition shows how much corporate India has matured since 1991. That was when the government began to dismantle the “licence raj” of bureaucratic controls that had hobbled Indian business. It was also the year Ratan Tata became chairman of Tata Sons, which has been at the forefront of Indian business's globalisation.

He oversaw a rationalisation of the group's hundreds of businesses. But it is still so diverse it sometimes seems to resemble a private-equity fund rather than a conglomerate. Besides steel, its interests include cars, hotels, mobile telephony, chemicals, tea and India's largest software firm. Most of these arms have expanded abroad through acquisition. About one-third of the group's revenues now come from overseas. In 2000, for example, Tata Tea spent $435m to buy Tetley Tea, a British business with a global brand. That was the first big foreign acquisition by an Indian company, and is in some ways a forerunner of the Corus bid. Both involve a high degree of leverage and would link an Indian resource base—tea plantations and iron ore—with global marketing reach.

Tata Steel is emblematic of the successful parts of Indian manufacturing. It is known as the lowest-cost producer in the world. It is one of the firms that thrived in the more competitive marketplace that emerged in India after the 1991 reforms, and have since been able to take on the best in the world. What is noteworthy about many of them is that the root of their success is not India's obvious competitive advantage: its vast, low-cost labour force. In the IT and outsourcing industries, lower salaries for college graduates are an important reason behind Indian firms' rapid growth. But in manufacturing the stars tend to be experts in automated, capital-intensive production. Bosses who have flourished in such businesses in India, with its poor infrastructure and still-daunting regulatory environment, understandably feel confident that they have lessons to teach their new purchases in other countries.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

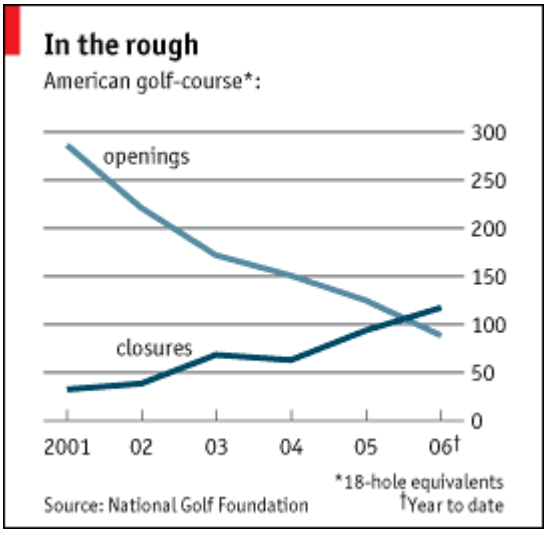
Golf in America

Blues on the green

Oct 12th 2006 | AUSTIN
From The Economist print edition

Why golf is in decline

MYRTLE BEACH, South Carolina, boasts of being the “Seaside Golf Capital of the World”. Alas, its thousands of retired citizens now have fewer places to tee up. Since 1999, 13 courses have opened, but 19 have closed. Most of the shuttered courses have been turned into housing developments to capitalise on high property prices. Nationally, closures will exceed openings for the first time this year (see chart).



This retrenchment may be no bad thing. In recent decades golf may have become the most over-built sport in America. The number of courses at Myrtle Beach more than trebled, to 105, in 25 years. “It's an issue of a market adjustment,” says David Graham, executive director of the Golf Association of Michigan, who says his state led the country in the past 10-15 years in course openings. Recently there have been several closures, which he attributes in part to the car industry's woes.

Worse still, the number of rounds played is down nearly 4% since 2000. One problem is that golf is expensive: the median fee for 18 holes is $40. Also, a round can take a full day, and who has time for that any more? In Myrtle Beach golf holidays are now four-day weekends rather than week-long extravaganzas, says Mickey McCamish, of Myrtle Beach Golf Holiday. Some courses even try to hurry patrons along.

Golf still reigns unchallenged as the corporate sport of choice. But it is often perceived as exclusive, so firms may prefer other forms of social activity in today's diversity-conscious climate, reckons Susan Amey, of the University of North Carolina's Kenan-Flagler business school. She also notes the rise of more inclusive “scramble” golf, in which everyone makes a shot, but the next shot is taken from the spot of the best player.

What lies ahead for the industry? Lawsuits, for one thing. The spate of recent closures has stirred ire all over the country. People with homes next to golf courses do not want McMansions to replace the greenery, not least because it might hurt their own property values. Two such suits are in play over course closures in Deerfield, in southern Myrtle Beach. Another looming worry is insurance. Premiums for courses along the Gulf Coast have soared by as much as 500% since last year's awful hurricane season, says Joel Willis junior of Clubsurance, a golf insurer.

Demography, if not the weather, may yet come to the rescue. After all, the baby boomers are about to retire—and they might just want to nip down to Myrtle Beach and swing some clubs.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

European airlines

The Italian exception

Oct 12th 2006 | LONDON AND PARIS
From The Economist print edition

Among Europe's flag carriers, Alitalia is faring worst against low-cost competitors

ITALY'S prime minister, Romano Prodi, this week described the nation's flag carrier, Alitalia, as out of control with no parachute. He said the government and the airline had only until January to hammer out a solution to avoid bankruptcy. So it looks as though Italy's flag carrier will at long last go the way of Swissair and Sabena, the Belgian flag carrier. Although the unions called off a one-day strike this week, they still exercise powerful control over any attempt to cut costs and drag the airline into the real world. An internal company report says the national carrier cannot make a profit even from capital already invested, and it cannot grow to survive because the more it flies, the more it loses. This week Alitalia's boss, Giancarlo Cimoli, was due to testify before a government committee, but his appearance was postponed and there were calls for his resignation.

AP

Another dissatisfied customer

A year ago Alitalia raised about €1 billion ($1.2 billion) in a rescue rights-issue of shares, backed by the government, which owns 49% of the airline. Then it was talking confidently of moving swiftly into profit. But its plans were all based on a super-optimistic forecast of a $40 oil price, even as it was heading over $60. Predictably, after a damaging round of strikes last spring, Alitalia's losses have grown again after shrinking a little. It made a loss of €221.5m in the first half of this year, up from €124.7m in the same period in 2005. Mr Prodi and Mr Cimoli are now trying to frighten the union into concessions to save the airline. But investors and frustrated travellers should not get their hopes up: Alitalia rescues come round as frequently and fruitlessly as changes of government. It has chomped its way through nearly €5 billion in the past ten years, to no avail.

Apart from the difficulty of cutting jobs and raising productivity in the Italian public sector, Alitalia is inherently less well-placed than other national airlines, such as Air France/KLM, Lufthansa and British Airways, to cope with the growing competition in Europe from vibrant low-cost carriers, led by Ryanair and easyJet. Whereas other flag carriers make about two-thirds of their revenues from long-haul flights, where there is no low-cost/low-fare competition, Alitalia has barely one-third of its business in long-haul. In its home market it faces fierce competition from four Italian budget airlines, plus the aggressive presence in the country of Ryanair and easyJet. Both long ago smelled the blood in the water around what a former easyJet boss called one of the most inefficient carriers in Europe.

Earlier this year Alitalia tried to buy the remains of one low-cost competitor, Volare, which went bust in

2004, only to have the deal overturned in a court challenge by a competitor earlier this month. Buying or starting an in-house low-cost carrier was one of the earlier strategies employed by flag carriers trying to fend off budget airline competition. But British Airways and Air France/KLM have now moved on to a more straightforward approach, although Lufthansa still has its own in-house budget carrier.

If you can't beat 'em...

The response of the more robust flag carriers to the low-cost challenge is now to attempt to match the budget airlines in their short-haul flights, while using them to feed traffic into their more profitable full-service long-haul routes. That is what Aer Lingus did successfully under Willie Walsh, whose success there earned him the top job at British Airways last year. No sooner was Aer Lingus privatised by the Irish government earlier this month than Michael O'Leary, the pugnacious boss of Ryanair, made a hostile bid for it—a move which underscores the emergence of the budget airlines as the dominant force in intra-European air travel. Exane BNP Paribas, a French investment bank, reckons that the low-cost carriers' share of the European internal market has grown from 24% last year to 27% now, and predicts that it will reach 33% by 2009.

Mr O'Leary's American investors were appalled by his bid, since the acquisition of Aer Lingus's conventional transatlantic long-haul routes would sully the purity of Ryanair's ultra-low-cost business model. But his move can simply be seen as opportunistic, since Aer Lingus was probably under-priced at sale. Taking control of Aer Lingus would also put him in a powerful position to stop Dublin airport's grandiose expansion plans, which he fears will put up landing charges at Ryanair's biggest base. And if an open-skies deal were ever signed between Europe and America, opening up London Heathrow, Aer Lingus has slots there which could be converted into transatlantic flights. Its brand would have great appeal to American travellers.

Air France/KLM, Lufthansa and British Airways—the Big Three of European aviation—have all deployed similar tactics in competing head-to-head with the budget airlines. For short-haul flights they have simplified their economy classes, introduced online reservations and virtually cut out travel agents' commissions. Catering has been reduced to sandwiches stored in the back of the plane, and Iberia, Spain's flag carrier, even charges for those now. There are usually three rather than four cabin attendants in economy class, and seat rows are crammed as close together as they would be in an easyJet or Ryanair plane. Meanwhile, poor old Alitalia still struggles to catch up.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

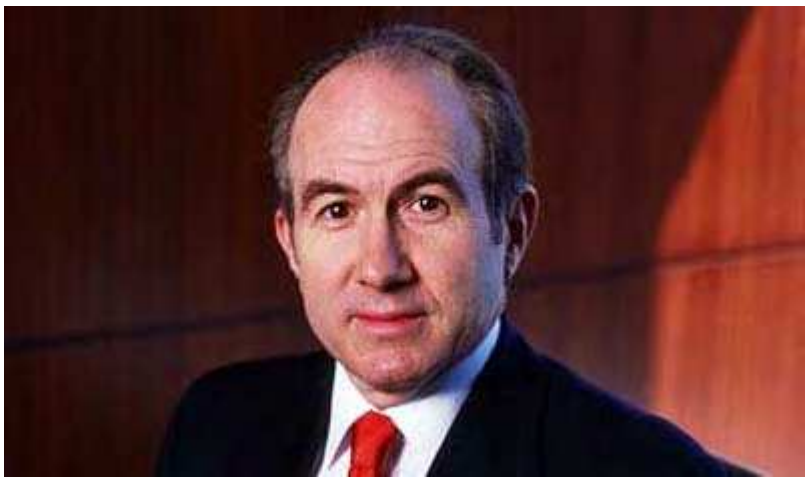
About sponsorship

Face value

The media industry's odd man out

Oct 12th 2006
From The Economist print edition

AP



Does Philippe Dauman, a corporate lawyer, have the creative flair to run Viacom?

FEW events have stunned America's media industry as did the firing on September 5th of Tom Freston, chief executive of Viacom, by Sumner Redstone, the firm's 83-year-old controlling shareholder, and his replacement by Philippe Dauman, a relatively unknown lawyer. “Psychotic” is how one rival media boss describes the move. Viacom's shares fell by nearly 8% on the news, though they recovered when Mr Dauman reassured Wall Street that he had no plans for big shifts in strategy. But investors worry that the man really running Viacom now may not be Mr Dauman, but Mr Redstone.

“I am Viacom,” the octogenarian founder has said, and he has a history of kicking out younger executives: the previous example was Mel Karmazin, Viacom's chief operating officer, just over two years ago. Mr Karmazin and Mr Freston had at least made names for themselves independently of Mr Redstone, whereas Mr Dauman largely has the mogul to thank for his career and fortune. They met in the 1980s when Mr Redstone was building his company and Mr Dauman was a brilliant young lawyer at Shearman & Sterling. When Mr Redstone faced a fight for control of the young Viacom, Mr Dauman helped to negotiate bank loans that secured the prize. He stayed at Mr Redstone's right hand, first on Viacom's board, then as its general counsel and later its deputy chairman. When his boss sought a merger with CBS in 2000, Mr Dauman bowed out so that Mr Karmazin, CBS's chief executive, could take charge. Mr Dauman is said to have been rewarded with a parting payment of around $150m, and started a private-equity firm called DND Capital Partners.

Trusted *consiglieri* are common in the media industry, says Lawrence Haverty, associate portfolio manager of the Gabelli Global Multimedia Trust, an investment company. Rupert Murdoch, he points out, turns to Stanley Shuman of Allen & Company, an investment bank; at Disney, Michael Eisner relied on Frank Wells. But as chief executive, Mr Dauman is the odd man out next to Mr Murdoch's chief operating officer, Peter Chernin, Time Warner's heir apparent, Jeff Bewkes, and Disney's Bob Iger—all of whom have experience of building media firms and an instinct for what people want to watch and listen to.

Mr Dauman could hardly be less like his predecessor. While he was devising mergers and acquisitions with Mr Redstone, Mr Freston was building MTV, a fledgling music video channel, into MTV Networks, a group of cable-television channels which now, along with BET, another cable channel, brings in just over 60% of Viacom's revenues. Mr Freston is an admired creative executive who works well with musicians and writers and who inspired his staff. Viacom now says he was too much of a hands-on operating executive to fill the top job and that he failed to communicate the firm's strategy effectively to Wall

Street. Viacom's share price fell 10% during his eight months as chief executive.

Most seriously, Viacom executives say that Mr Freston failed to expand the firm's digital businesses quickly enough. For this reason, says Mr Haverty, “Sumner had to do what he did.” Mr Redstone felt in particular that Mr Freston missed out on buying MySpace, a enormously popular social-networking website, which Mr Murdoch carried off last year. Other people at Viacom and at News Corporation say that this is unfair, and that it was Mr Redstone who stopped Viacom buying MySpace because he didn't want to overpay in a bidding war with Mr Murdoch.

Viacom's overall position in digital media is quite respectable, says Jessica Reif Cohen, media analyst at Merrill Lynch. Disney, she points out, lost hundreds of millions on various projects to get to where it is, and Time Warner messed up by merging with AOL. But there does appear to be a problem at MTV, which—unsurprisingly after 25 years—is showing signs that it is losing its resonance with young people. MTV has maintained its audience on television, but internet start-ups such as MySpace and YouTube, an internet-video firm bought by Google this week, are stealing its lunch online. MTV Networks' websites attract nowhere near as much traffic as the new upstarts.

Out with the old, in with the new

Mr Dauman's strategy, as well as to continue investing internally in new media, is to try to buy properties like MySpace at an early stage, before they get expensive—“at the college draft stage,” he told investors recently, “not when they're free agents”. His experience in private equity, Viacom hopes, will help him spot promising opportunities. However, he is not especially known as an investor in new media, and the investments DND Capital Partners has made public were both in small cable-television channels—the Tennis Channel and Si TV, a Latino-themed network—arguably more old media than new.

It is conceivable that MTV Networks could benefit from new ideas at the top. For now, Mr Dauman's immediate task is to stop Mr Freston's team falling apart. He says that he loves the culture at MTV Networks and is close to Judy McGrath, the division's chairman and other executives, who have been to his house several times in his 20 years at the company. The firm is now relying on one person, Ms McGrath, one of Mr Freston's closest colleagues, to maintain its creative energy. The problem, says Roger Fransecky of the Apogee Group, a consultancy, is that Mr Redstone's abrupt action has already sent a terrible message to the organisation: “Look out, I may have someone else up my sleeve.”

Would it be so awful if Mr Redstone really were back in the driving seat at Viacom, as in the good old days? He is after all one of the media geniuses of the age. But Mr Redstone's need to get the better of Mr Murdoch and other rivals may lead him to make other hasty decisions—an ill-judged acquisition, for instance—in his remaining years. If Mr Freston was indeed the wrong man, a wiser course would have been to appoint another strong, independent manager, not a loyal retainer.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com BUSINESS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

The Wallenbergs

Sweden's enduring business dynasty

Oct 12th 2006 | STOCKHOLM
From The Economist print edition

Gruppbild

They have had their ups and downs, but kept the family firm together for 150 years. Now the Wallenbergs once again consider reinventing their business

“THEY are a bit like royalty,” says Peter Thelin, a manager at Brummer & Partners, a Swedish hedge fund. He is describing the Wallenbergs, whose business counts as his most aristocratic investment. The Wallenbergs have been around a long time—even longer than the Bernadottes, the royal family who came to Sweden in the early 19th century when one of Napoleon's marshals was adopted as heir by an ageing Swedish king. But it was under the House of Bernadotte that the Wallenbergs rose to prominence and now run one of the world's most successful family firms.

By the late 1990s the Wallenbergs controlled some 40% of the value of the companies listed on the Swedish stock exchange. Their interests range from Ericsson, a leading telecoms firm, to Astra Zeneca, a pharmaceuticals company now listed in London, Electrolux, a white-goods manufacturer, and ABB, a global engineering giant. After Volkswagen, the family is also the second-biggest shareholder in Sweden's Scania, for which Germany's MAN, a rival truckmaker, has made a €9.6 billion ($12 billion) hostile bid. There is little that happens in Swedish business that does not involve the Wallenbergs.

What is the secret of their success? The family employs professional managers and has not been afraid to change. Some believe their next reincarnation could be as a private company. Despite denials that this strategy has been discussed, the Wallenbergs have the resources to buy back the shares of Investor, their main company. Moreover, they are making more private-equity investments.

Another generation

Moving with the times has helped the Wallenbergs before and could do so again. Few family businesses manage to survive beyond the third generation. A failure to develop the founder's business, together with disputes over dividing up the spoils, usually does in most family firms. Not the Wallenbergs, where the fifth generation hopes to hand over to the sixth.

The family quickly points to one factor that helps hold their enterprise together: “No one owns it, which

means that we cannot consume it though we can certainly destroy it," says Jacob Wallenberg, chairman of Investor. Most of the family's wealth is tied up in the Wallenberg foundations, which have combined assets of some SKr45 billion ($6.2 billion). These non-profit organisations provide grants of about SKr1 billion a year to science, research and the arts in Sweden. The foundations control 46% of votes at Investor and hold 22% of its capital, as well as owning big chunks of SAS, the main Scandinavian airline, Stora Enso, a huge paper company, and SKF, a maker of bearings.

The first and biggest of these foundations was set up in 1917 by childless Knut Wallenberg as a tax-saving way to keep the family wealth together. "Our first responsibility", says Jacob Wallenberg, "is to return capital to the researchers of this nation." Nor has the family confined itself to business. It has given Sweden a foreign minister, a Davis Cup player and Raoul Wallenberg, a hero of the second world war who rescued Hungarian Jews.

This year is the 150th anniversary of Skandinaviska Enskilda Banken (SEB), one of the Nordic region's biggest banks. It was founded by André Wallenberg and marks the start of the empire. Investor was set up 90 years ago for SEB's equity holdings in response to a law restricting banks' ownership of shares. Marcus Wallenberg (pictured on the left with his first cousin Jacob), is chairman of SEB. Both turn 50 this year.

Each generation of the Wallenbergs has done something to reinvent the family business. André Wallenberg was the financier of Sweden's industrialisation. Knut and his brother steered the family firm through the 1920s, when Sweden was badly hit by a global recession. Marcus Wallenberg, the tennis champion and grandfather of the present Marcus, ran the shop like an old-time industrialist—an apt strategy when post-war Europe was being resurrected. Peter Wallenberg, Jacob's father, became Investor's chairman in the 1980s and transformed it into a diversified investment company.

The present Marcus Wallenberg is driving the latest modernisation. He believes that the internet is for him the equivalent of the bet his grandfather placed on aviation. Marcus senior invested in Saab after the company was created in 1937. By 1946, he had sold out of railways altogether to concentrate on planes.

Marcus junior invested in Spray Networks, a Swedish internet portal, but this was a disaster. He also co-financed Bredbandsbolaget (B2), a provider of broadband and phone services. This too seemed to have failed, but Investor continued to back the company and last year it sold B2 to Telenor, a Norwegian media group, for a healthy profit.

Yet the outcome of Marcus Wallenberg's boldest technology investment is still uncertain. In 2000 he agreed to build 3 Scandinavia, a provider of third-generation mobile-phone services, in a joint venture with Hong Kong's Hutchison Whampoa. It is still leaking money, because subscribers are not switching to its services as fast as expected. The Wallenbergs agreed to fund 3 Scandinavia until 2008, when it is expected to break even. By then they will have paid between SKr8 billion and SKr10 billion for their 40% stake. If the firm is still in the red, will they let it go?

Loyal to a fault

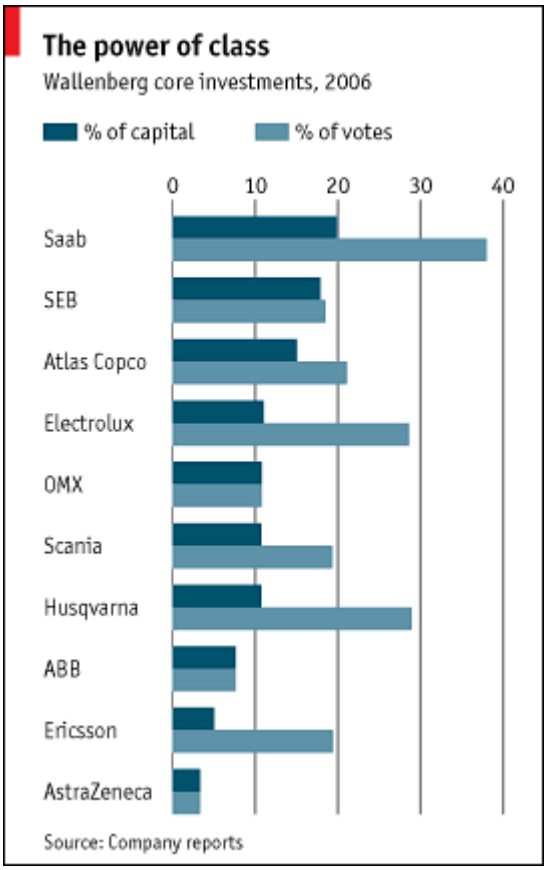
The family takes pride in sticking to its companies through thick and thin, but says it will not hesitate to sell when prospects seem permanently dim. When Marcus senior switched from trains to planes, he wrote in a letter to his brother that this meant "a shift from the past to the future, which has been the family motto in previous generations, and is the only tradition worth keeping". These values have not changed, says the younger Marcus. In the 1930s, Investor sold its coal and coke business because other forms of energy were being more widely used. And in the 1980s the Wallenbergs lost confidence in basic chemicals and got out of Kema Nobel.

Even so, loyalty and belief in the long term remain pillars of the Wallenberg way of doing business. Firms in the family sphere benefit from a network of carefully fostered contacts. Their bosses swap experiences and help each other search for talented executives. In return, the companies reward the Wallenbergs with multiple-voting shares and board seats. No important appointment is made without them. But this has its detractors and some suspect that the Wallenbergs concentrate more on preserving their powerful network than on the interests of Investor's 130,000 other shareholders.

"People say the Wallenbergs are only kingmakers," fumes Jacob Wallenberg in response. They are not, he insists, and take part in all important decisions on company strategy. Moreover, the family intends to become more actively involved, even though its stakes in some companies are likely to get smaller as a

result of mergers among global operators.

Today Investor has the biggest, or one of the biggest, shareholdings in ten blue-chip companies (see chart). But if Investor is to continue to thrive, it needs to do something about its investment discount. The company trades on average at some 25% less than the combined market value of its holdings, minus their share of debt. The firm's current market value is SKr119 billion. Although the discount is lower than it has been it is still “the biggest weakness of the Wallenberg empire,” says Mr Thelin, the hedge-fund manager. The discount restricts the ability to issue new equity to pay for big acquisitions.



The reason for the discount is the use of dual-class shares. Raffi Amit, who specialises in family firms at the Wharton business school, says that although dual-class shares give families more control, they tend to diminish the value of a corporation because other shareholders suspect the controlling family will grab special benefits for themselves or initiate strategic moves that help their business interests, but not those of other investors.

Perhaps the Wallenbergs should end their multiple-voting shares, especially as they are regularly under fire from Anglo-Saxon investors. But Sweden has long resisted this because some two-thirds of its listed companies have them and it helps keep firms under Swedish ownership in an open economy. Eight of Investor's core investments contain high-voting stock. Only the Anglo-Swedish AstraZeneca and the Swiss-Swedish ABB have converted to one vote per share. At Ericsson, the 1,000-fold voting rights of the Wallenbergs' A shares were reduced in 2004 to ten times the voting rights of B shares.

Jacob Wallenberg is a combative defender of multiple-voting shares. In his opinion, the Wallenbergs deserve their special rights because of their role in the foundation and development of the companies they have put their money into. Dual-class shares promote corporate Sweden's tradition of strong and involved ownership, says Rolf Carlsson, a management consultant. He thinks the system may survive at firms where Swedish ownership is considered important.

The actions of the Wallenbergs' managers have helped to reduce the discount. So far, SEB is thriving under its newish chief executive, Annika Falkengren. Börje Ekholm took over as chief executive of Investor in September last year after running Investor Growth Capital, the venture-capital arm in New York. Compared with the patrician Wallenbergs, Mr Ekholm cuts a bolder, more hands-on figure. He has certainly been busy making changes.

In May he joined forces with EQT, a Swedish private-equity company, to buy out Gambro, a Swedish medical-technology company. In June he pushed for the spin-off of Husqvarna, a maker of chainsaws and other outdoor equipment, from Electrolux. And in August he sold Investor's stake in WM-Data Nordic, an information-technology consultancy. The deals continue. Apart from the unresolved Scania bid, Atlas Copco recently agreed to sell most of its construction-equipment rental business, also to private-equity investors, for $3.8 billion.

Mr Ekholm intends to look at riskier, but more lucrative, unlisted investments, which now make up 16% of Investor's net asset value. Investor has become a big investor in private equity through its part-ownership of EQT and Investor Capital Partners, a subsidiary based in Hong Kong. Through Investor Growth Capital it finances fledgling companies in health care and technology in America. And it is the owner of other unlisted firms, such as Novare, a head hunter, and Stockholm's Grand Hotel. The advantage of these assets, says Mr Ekholm, is that “our work with them only benefits our investors”.

What to buy?

Investor is sitting on a pile of cash and is nearly debt-free. Stockholm's financial circle hums with

speculation about what Mr Ekholm might do with this money. He could make a big acquisition or buy back shares. Mr Ekholm says he will look for takeover targets in financial services, technology, health care and engineering. But neither does he rule out a share buy-back.

Could he take all of Investor private and transform it into a gigantic private-equity firm? Simon Blecher, of HQ Fonder, an investment fund, calculates that the company could mobilise some SKr25 billion immediately and release another SKr40 billion in the short term, which could go a long way towards a buyout. Investor could then re-list some of its private-equity funds. This has worked for Ratos, a middle-sized Swedish investment firm, which used to trade at a big discount. Ratos now trades at a premium. Mr Ekholm, though, denies that the Wallenbergs have ever discussed taking Investor private.

The next generation, however, is waiting in the wings. The Wallenberg cousins have 11 children between them. “Of course it would be wonderful if they were interested,” says Jacob Wallenberg. It is what the family expects. But if the sixth generation takes up the reins it will have its own ideas about the future of the family firm.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

China's biggest bank

A dragon stirs

Oct 12th 2006 | HONG KONG
From The Economist print edition

Investors flock to the world's largest-ever listing, but ICBC reflects China's murkier side as well as its promise

IF A single transaction could sum up the knowns and unknowns surrounding China's red-hot economy, it would be the public offering of ICBC, the Industrial and Commercial Bank of China. The largest of China's large banks and the last of the relatively healthy ones to list on an exchange, it is scheduled to price its shares on October 20th and to begin trading a week later. These dates, normally dry minutiae in a banker's diary, are as eagerly awaited as national holidays in some parts of China.

On October 9th the preliminary prospectus was published like a bestseller, a 600-page door-stop that appeared in the office of every bank and hedge fund in Hong Kong. Anyone with a chequebook had an opinion. The new issue, which will be sold in Hong Kong and Shanghai, will almost certainly beat the record for an initial public offering of $18.4 billion set in 1998 by a Japanese mobile-telecoms operator. If priced near the top of the range (which is likely), the sale will pull in $22 billion, placing ICBC among the ten most highly valued banks in the world, with a market capitalisation close to $130 billion. As a result, it will be a big part of the region's share indices. Bets on ICBC will make, or break, careers.

A presentation this week for 170 invited investors in Hong Kong drew a crowd twice as large. That started a global roadshow which reached Europe by the end of the week, and will then move on to America. Already Hong Kong tycoons and Middle Eastern investors are involved. American institutional investors are expected to take the single largest slice.

It is debatable how much of this marketing is necessary. Within an hour of the formal solicitation of bids by institutional investors, the entire order book had been filled. By the end of the first day investors had placed bids for three times the number of shares on offer. By the close of the next day it was nine times subscribed. A thin slice will be allocated for retail investors on October 16th; demand is expected to be huge, not least because there is no restriction on ordinary investors “flipping” the shares quickly if, as expected, there is an opening pop in the price.

Normally, with a deal this hot, bankers and company officials would increase the size and price of the

offering. But ICBC is subject to abnormal political considerations. Ever since the troubled 1999 public offering of China National Offshore Oil Corporation (CNOOC), which failed on its first effort, China has been eager to sell shares in a way that pleases investors and does not cause the government embarrassment—if nothing else because it has lots more companies to auction.

A successful sale would be particularly gratifying for the government because for international investors, ICBC is something of a proxy for China itself: vast, diverse, growing fast, and with extraordinary scope for internal restructuring. It is by all relevant measures the largest bank in China and the Chinese banking market is even hotter than the country's economy. Every year, from the end of 2001 to the end of 2005, personal loans grew by a third, deposits by 19% and corporate loans by a percentage in the mid-teens. Since deposit rates are, by law, low, and the spread between them and lending rates quite large, the growth has been enormously lucrative. ICBC's profits doubled in the past two years. Its growth has also created extraordinary windfalls for some, and aroused more than a whiff of jealousy among others. Goldman Sachs was allowed to purchase a 5.8% stake in April for $2.6 billion, its largest investment ever. The American investment bank will possibly have tripled its money by the end of this month.

Other American banks, denied a foothold in ICBC, are scrambling to make up for it wherever they can. Citigroup, for example, is in the final stages of a gruelling two-year battle to buy perhaps 20-25% of Guangdong Development Bank, a troubled institution (though some rivals also have an eye on it). Morgan Stanley has announced its acquisition of Nan Tung Bank, one of the few Chinese banks that, thanks to a loophole (ownership by the Bank of China through a Macau subsidiary) could be bought. Although the deal may come with valuable licences, it is tiny. With only one branch, 40 employees and a business exclusively in non-Chinese currencies, it is a wonder Morgan Stanley even knew Nan Tung existed.

But ICBC, however valuable, also reflects the murkier side of life in the Chinese economy. Political considerations often come first, information is unreliable, and openness in the banking system is questionable, despite conditions tied to China's entry into the World Trade Organisation.

Only last year, the government injected $15 billion to cover rotten loans at ICBC. At the time, more than a fifth of the bank's portfolio was, as bankers say, “non-performing.” Even now, despite putting modern credit systems in place and curbing politicians' ability to apply pressure to grant poor loans, almost 5% of its portfolio is delinquent: a worthy improvement, but not yet up to Western standards.

Its size also carries a cost. In the past decade it has reduced the number of branches from 42,000 to 18,000, but may need to slim further. Unlike many Chinese banks, ICBC has not had substantial legal problems in its upper ranks, but there have still been scandals, reflecting the complexity of managing a vast institution in China. In February 2005 the Hunan branch manager was convicted of bribery and sentenced to 19 years in jail. In April an assistant branch manager in Guangdong was found guilty on a similar charge and sent down for 12 years. ICBC's size also makes it vulnerable to consumer fraud. Credit bureaus are young and inexperienced, which means analysis of borrowers by individual banks might not catch those receiving loans from multiple sources.

Depending on the final price, ICBC will probably stand above two times its book value, slightly below its peers. This is a modest multiple for a good bank in a good economy, but higher than those for South Korean or Taiwanese banks, which do not have the same growth prospects. On the other hand, they are not shrouded in the same mysteries. In China, the sceptics (and they are rare) ask, what is book? How much are the assets really worth? Their voices, no doubt, will barely be heard amid the deafening clamour for shares.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Buttonwood

Roll over

Oct 12th 2006
From The Economist print edition

Overcrowding is unbalancing the world of commodities

SOD'S law has been at work again. No sooner have investors rediscovered the lure of commodities than their own enthusiasm has ruined the rationale.

As an idea, commodities sounded great. Investors made too big a bet on shares in the 1990s. Bonds offered too low a yield to produce exciting long-term returns. Commodities promised a decent long-term narrative (Chinese and Indian demand) and the prospect of diversification, the only free lunch in the investment world: positive returns that are not correlated with other asset classes.

Then something went wrong. Much has been made of the exciting long-term returns from benchmarks such as the Goldman Sachs Commodity Index. But the GSCI, which has a heavy weighting in oil, is showing a loss this year.

Part of the reason is that futures prices have moved above spot, or current, prices. Usually, futures prices have tended to be below spot prices. This created a positive “roll yield” for commodity investors, who could hold on to contracts until they became more valuable. However, the roll yield has now turned negative, so that investors in futures contracts are losing. In the year to date the roll yield has been minus 13.35%, and the annualised yield on the next two months' contracts is minus 38.4%.

Investors may actually have caused their own difficulties. As they have tried to exploit the positive roll yield, the returns have disappeared.

A wider problem may be at work. Diversification depends on reduced correlation. Commodities were a pretty neglected asset class in the 1990s, so it was no surprise they failed to move in tandem with shares. But now they have become mainstream, the correlation seems to have increased. Shares and commodities are both plays on global growth.

Commodities have certainly become more closely linked to each other. Over the five years to December 2005, the correlation between oil and gold was just 0.13, according to Capital Economics, a consulting firm (perfect correlation would be 1). In the past six months it has been 0.64.

This could be due to inflation. In recent weeks, as the oil price has fallen, so have inflationary concerns, leading investors to sell gold, which is traditionally seen as a hedge against rising prices. But gold has also become much more strongly correlated with base metals. This suggests another factor; the flow of investment money into commodity indices. When pension-fund investors buy an index, all the components are bought indiscriminately, regardless of their true value.

It is a classic paradox. What works for the individual cannot work for the group. Yogi Berra, the baseball player, grasped the problem when he said: “Nobody goes there any more; it's too crowded.”

The herd instinct explains why investors are buying commodities several years into a bull run. According to Merrill Lynch, a sign of speculative excess is that the spread between prices of listed commodities (bought by investors) and unlisted products is a record 60%.

There are still plenty of believers in the long-term commodity case. Apart from Chinese demand, the bulls point to restrictions in supply, caused by years of underinvestment and the time needed to bring new resources into production.

However, this applies only to some commodities. It is easy to boost agricultural production pretty quickly. Gold is rarely driven by industrial demand but by the yellow metal's perceived value as an alternative currency and by the reserves policies of central banks.

Other metals are driven more by supply and demand and represent a play on global growth. But the unwary investor can still be caught out if he relies too blindly on the China case; in steel, for example, the People's Republic has moved recently from being a huge consumer to becoming a net exporter.

Oil sits in a category of its own. It is an indicator of geopolitical risk. And it also acts as an automatic regulator for the economy; hitting consumer spending when its price rises and boosting it when it falls. Even attempts by the Organisation of the Petroleum Exporting Countries to agree on production cuts have failed to halt its decline.

As investors become more sophisticated, they will move away from commodity indices. Kevin Norrish, director of commodities research at Barclays Capital, says there has been a surge of issuance in structured products, investment vehicles that deliver a return tied to specific commodity prices. Another implication is that investors need to realise that the best time to diversify into an asset is when no one else wants to do so.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

The Nobel prize for economics

A natural choice

Oct 12th 2006
From The Economist print edition

Edmund Phelps earns the economics profession's highest accolade

AP

Phelps's time has finally come

BORN in the trough of the Great Depression, Edmund Phelps, a professor at Columbia University who this week won the Nobel prize for economics, has spent much of his intellectual life studying slumps of a different kind. The Depression, which cost both of his parents their jobs, was exacerbated by the monetary authorities, who kept too tight a grip on the money supply. Mr Phelps is interested in unemployment that even open-handed central bankers cannot cure.

Most scholars stand on the shoulders of giants. But Mr Phelps won his laurels in part for kicking the feet from under his intellectual forerunners. In 1958 William Phillips, of the London School of Economics, showed that for much of the previous hundred years, unemployment was low in Britain when wage inflation was high, and high when inflation was low. Economists were quick—too quick—to conclude that policymakers therefore faced a grand, macroeconomic trade-off, embodied in the so-called “Phillips curve”. They could settle for unemployment of, say, 6% and an inflation rate of 1%—as prevailed in America at the start of the 1960s—or they could quicken the economy, cutting unemployment by a couple of percentage points at the expense of inflation of 3% or so—which is roughly how things stood in America when Mr Phelps published his first paper on the subject in 1967.

In such a tight labour market, companies appease workers by offering higher wages. They then pass on the cost in the form of dearer prices, cheating workers of a higher real wage. Thus policymakers can engineer lower unemployment only through deception. But “man is a thinking, expectant being,” as Mr Phelps has put it. Eventually workers will cotton on, demanding still higher wages to offset the rising cost of living. They can be duped for as long as inflation stays one step ahead of their rising expectations of what it will be.

The stable trade-off depicted by the Phillips curve is thus a dangerous mirage. The economy will recover its equilibrium only when workers' expectations are fulfilled, prices turn out as anticipated, and they no longer sell their labour under false pretences. But equilibrium does not, sadly, imply full employment. Mr Phelps argued that inflation will not settle until unemployment rises to its “natural rate”, leaving some workers mouldering on the shelf. Given economists' almost theological commitment to the notion that markets clear, the presence of unemployment in the world requires a theodicy to explain it. Mr Phelps is willing to entertain several. But in much of his work he contends that unemployment is necessary to cow workers, ensuring their loyalty to the company and their diligence on the job, at a wage the company can afford to pay.

“Natural” does not mean optimal. Nor, Mr Phelps has written, does it mean “a pristine element of nature not susceptible to intervention by man.” Natural simply means impervious to central bankers' efforts to change it, however much money they print.

Economists, including some of his own students, commonly take this natural rate to be slow-moving, if not constant, and devote a great deal of effort to estimating it. Mr Phelps, by contrast, has been more anxious to explain its fluctuations, and to recommend measures to lower it. His book “Structural Slumps”, published in 1994, is an ambitious attempt to provide a general theory of how the natural rate of unemployment evolves. Some of the factors that he considered important—unemployment benefits or

payroll taxes, for example—are widely accepted parts of the story. Others are more idiosyncratic. He and his French collaborator, Jean-Paul Fitoussi, have, for example, blamed Europe's mounting unemployment in the 1980s in part on Ronald Reagan's budget deficits, which were expansionary at home, but squeezed employment in the rest of the world.

A few years ago David Warsh, an economic journalist, lamented that the glare of the Nobel prize left other equally deserving economists, such as Mr Phelps, languishing “in the half-lit penumbra of the shortlist”. This week, after an unaccountably long lag, professional acclaim for this bold, purposeful theorist finally converged on its natural rate.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Visa's flotation

Plastic coating

Oct 12th 2006
From The Economist print edition

High hopes as the world's biggest credit card plans a share offer

VISA, which calls itself “the world's leading credit-card”, doesn't like coming second. But on October 11th the company said that it would float its businesses outside Western Europe within the next year and a half. Some of its reasons for going public echo those of its arch-rival MasterCard, which raised $2.4 billion in an initial public offering (IPO) in May. Cash raised in the flotation can be used for expansion in growing markets such as Asia's. A reorganisation will also loosen banks' control of Visa.

That could help defuse the barrage of lawsuits facing it. Visa's IPO, like MasterCard's, would transform it from an association owned by its 20,000 member banks into an independent public company. This could undermine the charge that its member banks collude to set artificially high “interchange” fees (fees that merchants who accept Visa cards must pay to banks).

Other lawsuits allege Visa barred competitors like American Express and Morgan Stanley's Discover from issuing their plastic through banks that offer Visa cards. A listing will be of little help there—except that some of the cash raised can be set aside for future legal settlements, which are considered likely.

Investors probably care less now about litigation than when its rival went public. MasterCard's shares have climbed by around 80% since its IPO in May, despite an unpromising debut. The future could be even brighter for Visa. It is already by far the lowest-cost processor of credit-card transactions, says David Robertson of the *Nilson Report*, a trade publication. It holds 60% of the world market in payments based on total card spending—over twice MasterCard's share. And there is still ample room for growth. According to Global Insight, a research company, an estimated 70% of the $26 trillion spent globally on personal items is still paid by cash or cheques. Visa might well find that its late start turns out to be no disadvantage.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Catastrophe insurance

Balmy in Bermuda

Oct 12th 2006
From The Economist print edition

A light hurricane season may provide a windfall for hedge funds

HURRICANE FLORENCE had an immaculate sense of timing. When she shot through Bermuda last month she cut power, blew out windows and was blamed for the deaths of two flamingos at the local zoo (killed by falling branches). Just as she was bearing down, though, most of the people who make Bermuda a global hub for insuring against natural catastrophes were at an industry conference in sunny Monte Carlo.

In contrast to the deadly (and costly) hurricanes of 2005, Florence was a wisp of a storm. That has been the pattern all season. Despite warnings from weather forecasters early this year that more ferocious storms were likely, the hurricane season—which will end in a few weeks—has so far been docile. This is good news not just for homeowners and businesses spared devastation; investors who have poured money into a growing market for catastrophe risk are set to make a fortune. Increasingly, these include hedge funds.

Part of the expected windfall in 2006 stems from the wrathful weather last year. Hurricanes account for the vast majority of insurance catastrophes; the insured loss from Katrina last year ($45 billion) was more than twice that from the terrorist attacks of September 11th 2001 ($21 billion). The losses suffered by insurers last year caused a big rethink of the catastrophe market, and many reduced coverage.

Normally, new sources of capital tend to flock in after disaster strikes, replacing some of what is paid out or withdrawn by hard-hit insurers who scale back on the business. Barney Schauble, of Nephila Capital, a Bermuda hedge fund, estimates that insurers pulled out more than $100 billion of capital last year, while $20 billion to $30 billion of new money flowed in. “Net, there was quite a large hole,” he says. With tougher capital requirements on catastrophe reinsurers from rating agencies, that led to big premium increases in America when contracts were renewed in January and July (they were flatter in Europe and Asia). Hedge funds sniffed an opportunity and moved in. “There was a shortage of capital and they supplied the capital,” says Donald Thorpe, of Fitch, a ratings agency. “They're quite opportunistic and it looks like they will do pretty well this year.”

Some hedge funds, such as Nephila, have started their own reinsurers. But returns so far this year appear promising in a wide array of catastrophe-related investments. Data from Merrill Lynch, for instance, show that insurance-company bonds in both America and Europe—particularly those tied to catastrophe risk, such as Swiss Re's and AIG's—have performed better than other investment-grade securities in recent months.

There is also a growing market in catastrophe bonds, which offer investors a chance to bear some of the cost of paying insurance claims if disaster strikes. The bonds, which carry highish yields, are increasingly favoured by mutual funds and other investors.

Despite the insurance industry's focus on weather and climate change, a recent survey by the Economist Intelligence Unit, a sister company of *The Economist*, shows that company executives are more concerned about terrorism than about weather-related risks. That, sadly, is as hard to predict as hurricanes.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

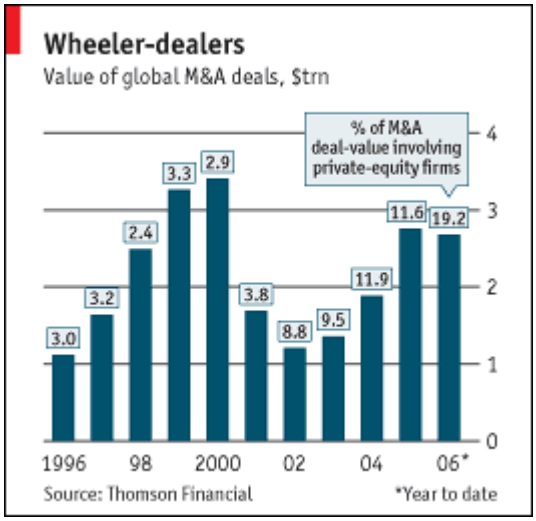
About sponsorship

Banks and buy-outs

Follow the money

Oct 12th 2006 | NEW YORK
From The Economist print edition

Banks cannot resist the perilous lure of private equity



WITH money pouring into private equity at a dizzying rate, it is hard to wipe the smiles off the faces of its practitioners. This week, however, the mood darkened a little. News reports said that America's Department of Justice (DoJ) had launched an inquiry into possible collusion among bidders in private-equity deals. And as funds with huge fortunes to invest chase a shrinking number of targets, rating agencies are once again sounding alarm bells over credit quality.

Time to rush for the exit? Not for Wall Street's finest, it would seem. Morgan Stanley is pushing ahead with a return to the business, hoping to raise up to $5 billion in a buy-out fund. So is Credit Suisse, which just last week raised $2.1 billion. Bear Stearns and Lehman Brothers raised more than $4 billion between them in the third quarter. This is not the first time the banks have entered the business. Most had big private-equity operations for a brief period in the late 1980s. There was another flurry five years ago, but some retreated again after facing the wrath of their private-equity clients. Morgan Stanley and JPMorgan Chase, for instance, both spun off their buy-out arms to managers.

There were good reasons for their change of heart. Buy-out firms complained that banks which were supposedly advising or lending to them sometimes snatched deals from under their noses. A notorious example was the battle for Warner Chilcott, a British drugmaker, in late 2004: while working with buy-out firms bidding for the company, Credit Suisse teamed up with JPMorgan Chase to launch a bid of its own. The outcry that followed persuaded the Swiss bank to scale back its private-equity operations. Buy-out firms also worry that bank-run funds will lure away money from pension funds and other investors that they themselves might otherwise have got.

The potential for bust-ups between banks and clients has not gone away. “They retreated because of conflicts, and they are returning despite those conflicts still being present,” says an executive at one private-equity firm. But this time the banks insist they want to stay on the right side of their clients. That means that whenever possible they say they will try to co-operate in “club” (consortium) deals. Aggressive counterbids are not being encouraged. Lehman has even decided to stick to minority investments, so as not to upset clients.

For some, the model to follow will be the one big bank that has long remained a force in the private-equity business: Goldman Sachs. It has, for the most part, managed its potential conflicts deftly; and when it has angered clients, there have been rebukes from the top. But there is no denying that banks compete with buy-out firms, too. Investment bankers have more opportunities to spot potential targets before they go on the block. Rivals say this is how Merrill Lynch won a big role in the record takeover of HCA, a health-care group, in July, for $33 billion including debt.

But regulators or a market downturn may yet spoil the fun. The DoJ's inquiry into possibly anti-competitive behaviour, reported in the *Wall Street Journal*, is informal at this stage, and lawyers say proving collusion in club transactions is likely to be difficult. However, the banks' stated determination not to compete too aggressively with private-equity clients this time around may not help their cause with the regulators. Nor are scandals likely to help. The Securities and Exchange Commission is looking into whether AA Capital, a buy-out fund spun out from ABN Amro, a Dutch bank, misappropriated $11m

of its clients' money.

Steven Kaplan, a finance professor at the University of Chicago, thinks the private-equity industry may be less prone to trouble than hedge funds, another trendy investment, in part because it has less scope for creative valuation. Nevertheless, as the industry grows, so does the risk of a blow-up—and more regulatory scrutiny.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Wine economics

Fruity little numbers

Oct 12th 2006
From The Economist print edition

Whichever way you value wine, its price is going up

FOR all those tipplers who, if blindfolded, could not taste the difference between a claret and a bottle of plonk, here's intoxicating news. The value of wine is as much about the bottle as what is inside.

AFP

For cave dwellers, they smell surprisingly good

The relationship between the price of a bottle of wine and its taste is weak, according to two studies in the inaugural issue of the *Journal of Wine Economics*. Using a price equation to compare more than 1,000 bottles of Bordeaux and Burgundy wines tasted blindly by experts, Sébastien Lecocq and Michael Visser, of the French National Institute for Agricultural Research (INRA), find that the price of wine is largely determined by objective standards such as colour, ranking and vintage, rather than simply by taste and smell.

Similar results were found by Pierre Combris and Sylvie Issanchou, of INRA, and Christine Lange, of France's National Centre for Scientific Research, who observed how 120 people bid on non-vintage champagne after tasting it blind, after inspecting only the bottle, and after tasting it while seeing the bottle. The bidding was 33% higher when tasters could only see the bottle than it was with blind tasting, implying that the champagne's taste detracted from its perceived value.

“The label is a big part of the glamour,” says James Miles, director of the London International Vintners Exchange, an electronic exchange for fine wine. But although wine's intrinsic value may be debatable, its market value is not. Investing in wine has become a popular way of diversifying a financial portfolio. In 2002, when the FTSE 100 share index fell by 24.5%, the Decanter Bordeaux Index of 1,300 wines went up by 8.5%, according to “Wine Investment for Portfolio Diversification”, a book by Mahesh Kumar. The Liv-ex 100 wine index, which tracks the price of 100 fine wines, has risen by 55% in the last year and the fine-wine market is now worth more than £1 billion ($1.9 billion), according to Mr Miles. Hype generated this year by the 2005 Bordeaux, considered the best in a generation, has helped.

Interest in wine investment has also spurred the creation of new wine funds, including the Fine Wine Fund in August, charging a 2% management fee and 15% performance fee. Better availability of price information and more demand for wine in emerging markets has created a fine-wine bull market.

Despite its recent resurgence, fine wine remains a luxury investment that carries risks. Rarity depends on the whims of weather and demand can fluctuate. But at least investors can take comfort that this liquid asset is drinkable—and that what tastes best is not always dearest.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Hedge funds

Back in business

Oct 12th 2006 | FRANKFURT AND LONDON
From The Economist print edition

A trader's trespasses are forgiven

EVEN tarnished stars shine brightly in the world of hedge funds. So it was no shock to fund managers when news broke this week that Philippe Jabre, a high flier who was fined by Britain's financial regulator just months ago for market abuse, has reinvented himself in Switzerland and found some deep-pocketed investors to back him. Indeed, many had eagerly awaited his return.

Born in Lebanon, Mr Jabre has lit up the London hedge-fund orbit for two decades. He is known for a keen intellect, a willingness to take risks, and years of impressive returns in convertible-bond arbitrage. One of his funds generated annual returns of more than 23% between 1998 and 2005.

When the Financial Services Authority (FSA), the regulator, fined him and his firm, GLG Partners, each £750,000 ($1.3m) in the spring, it did not bar him from managing money. Only later, when Mr Jabre left GLG, did the firm ask the FSA to withdraw his licence. There was immediate speculation at the time about his plans for another fund. This week he was reported to be raising $2 billion or more from investors, to be managed in Geneva.

Switzerland has long been a centre for hedge funds thanks to its private banks and rich individuals. It is home to about 150 registered managers, most of them funds of hedge funds. The Swiss will allow Mr Jabre to run an offshore fund there without approval from the EBK, the federal watchdog, as long as he does not solicit money from more than 20 investors a year. A new capital-investment law, due to come into force in January, does little to change this approach. In Britain he would have to get new approval from the FSA to manage money, since he was dropped from its approved list when he left GLG.

This is not the first time a hedge-fund manager has taken a knock yet retained his credibility with investors. Another was John Meriwether, who left Salomon Brothers in 1991 after a treasury bond-auction scandal, set up Long-Term Capital Management which then imploded, and raised about $1.9 billion for his latest firm, which started a year later. “In the hedge-fund industry the only bad thing you can do is lose people's money,” says a financial consultant. That is not the sort of message the regulators will like to hear.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economics focus

Home truths

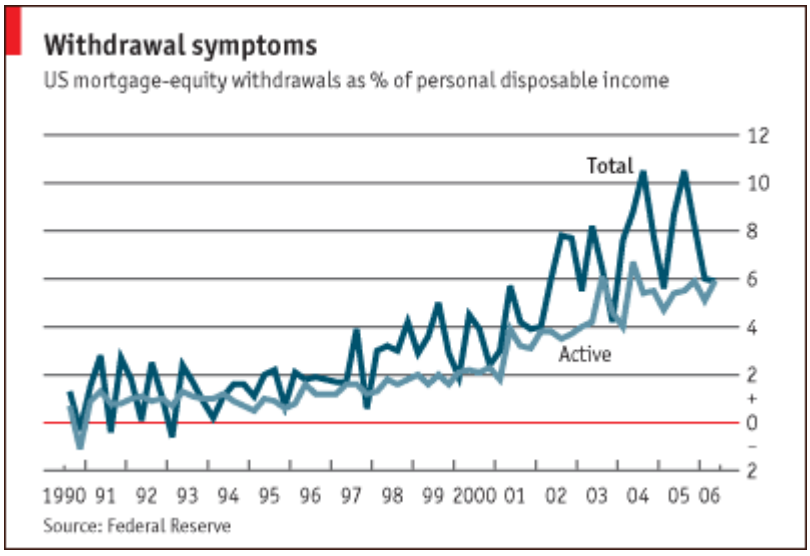
Oct 12th 2006
From The Economist print edition

How much does housing wealth boost consumer spending?

BEN BERNANKE, the chairman of the Federal Reserve, speaks of a “substantial correction”. Others use more lurid language. But no one doubts that America's housing market is in trouble. After several years of double-digit growth, house prices have slowed sharply. By some measures they are falling. Today's debate is about the consequences, particularly for consumers. Will Americans slow their spending gradually or suddenly, and by a little or a lot? At issue is whether people treat their housing wealth like a nest egg or like a cash card.

Optimists, Mr Bernanke among them, argue that the links between housing wealth and spending are much the same as for any other type of wealth, such as shares. When house prices rise, so does people's prosperity. In response to this greater affluence, they gradually increase their spending. When house prices fall, they cut back in a similar way. The consensus is that a $100 drop in wealth, over time, reduces spending by about $3-5 a year. That suggests weakening house prices would have a fairly small, gradual effect on consumer spending.

Nonsense, say the pessimists. Weaker house prices, they argue, will have a bigger and more immediate impact than the “wealth effect” suggests, because Americans have been paying for their spending binge by borrowing against the rising value of their homes. According to calculations by Alan Greenspan, Mr Bernanke's predecessor, and James Kennedy, a Fed economist, mortgage-equity withdrawal—the amount of cash people extract from their homes through bigger mortgages, home-equity loans and so forth—has soared in recent years. It peaked at more than 10% of personal income a year ago (see chart). In a speech last year Mr Greenspan pointed to evidence from surveys that people spent around half of the cash they released from their homes. That suggests a slowing of mortgage-equity withdrawal could drag down spending far and fast.



More than a roof over your head

The stakes in this debate are high, because the behaviour of consumers will largely determine whether America's economy tumbles into recession or merely slows down. Unfortunately, there is no simple answer. Economic theory tends to support the optimists. Rational consumers should adjust their long-

term spending in response to changes in their wealth, not the ease with which they can tap it. But there are several reasons why the wealth effect from housing could differ from that of shares and bonds. People have to live somewhere, and as the price of property goes up, the notional cost of housing rises with it, even for owner-occupiers. That means rising property prices do not create aggregate gains in the way that higher share prices do. Housing's effect on overall spending should therefore be smaller than that of financial wealth. On the other hand, more people own homes than own financial assets. Since poorer people tend to save less than richer ones, higher house prices ought to boost spending more than rising share prices.

Empirically, economists have long had trouble pinning down the wealth effect from housing. Two decades ago, it was considered to be non-existent. Then studies found that changes in property values did affect spending, but by less than changes in share prices did. However, the latest research suggests that, in America at least, housing wealth has a bigger influence on consumption than financial assets, and the effect is increasing.

A new study by Christopher Carroll, Misuzu Otsuka and Jirka Slacalek estimates that an increase in housing wealth of $100 in America eventually boosts spending by $9. A similar increase in stockmarket wealth would produce only $4 more spending. That ties in with a new microeconomic analysis of individuals' wealth and spending habits by Raphael Bostic, Stuart Gabriel and Gary Painter, which estimates that the wealth effect from housing is around three times bigger than that of financial assets. A study by Karl Case, John Quigley and Robert Shiller also found the wealth effect from housing to be more significant than that from shares.

In another study, Mr Slacalek finds that in industrial countries, the effect of a change in housing wealth on spending has risen in the past 15 years. But whereas in America and Britain it is now bigger than that of financial assets, in most other countries the wealth effect from share and bond portfolios is still greater. One reason for this difference is that Anglo-Saxon economies have more sophisticated instruments through which people can take cash out of their homes, through the ability to refinance mortgages, for example.

All of which suggests that Wall Street's optimists may understate the impact of weaker home prices on spending. By the same token, however, the pessimists may exaggerate how much the recent rise in equity extraction has fuelled an unsustainable spending binge. First, some of the withdrawal of housing equity is a natural consequence of turnover in the property market, as older people move to smaller homes, sell to younger folk and put the substantial wealth they have accumulated as house prices have risen into other investments. Exclude this type of “passive” equity withdrawal, and the pace at which Americans have been actively taking money out of their houses is lower, close to 6% of disposable income (again, see chart). Recent survey evidence also suggests consumers are using more of their home equity to pay off other borrowings, such as credit-card debt. (That is no surprise, because mortgage debt in America carries huge tax advantages.) This may indicate that Americans are managing their debts prudently, not spending recklessly.

Both sides can point to evidence supporting their cases. Optimists note that the housing slowdown has so far had scant impact on consumer spending. Pessimists say that is because the pace of active mortgage-equity extraction has not yet slowed. The truth, most probably, will lie somewhere in between.

“How Large is the Housing Wealth Effect? A New Approach”, by Christopher D. Carroll, John Hopkins University; Misuzu Otsuka, Asian Development Bank; Jirka Slacalek, German Institute for Economic Research. October 2006

“What Drives Personal Consumption? The Role of Housing and Financial Wealth”, by Jirka Slacalek, German Institute for Economic Research. September 2006

"Housing Wealth, Financial Wealth, and Consumption: New Evidence From Microdata", by Raphael Bostic, Stuart Gabriel and Gary Painter, Lusk Center for Real Estate, University of Southern California. July 2006

“Comparing Wealth Effects: The Stock Market Versus The Housing Market”, by Karl E. Case, John M. Quigley and Robert J. Shiller, Advances in Macroeconomics, Berkeley Electronic Press, Vol 5 (1) 2005

“Estimates of Home Mortgage Originations, Repayments, and Debt on One-to-Four Family Residences”, by Alan Greenspan and James Kennedy, Federal Reserve Board Finance and Economics Discussion Paper 2005-41

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

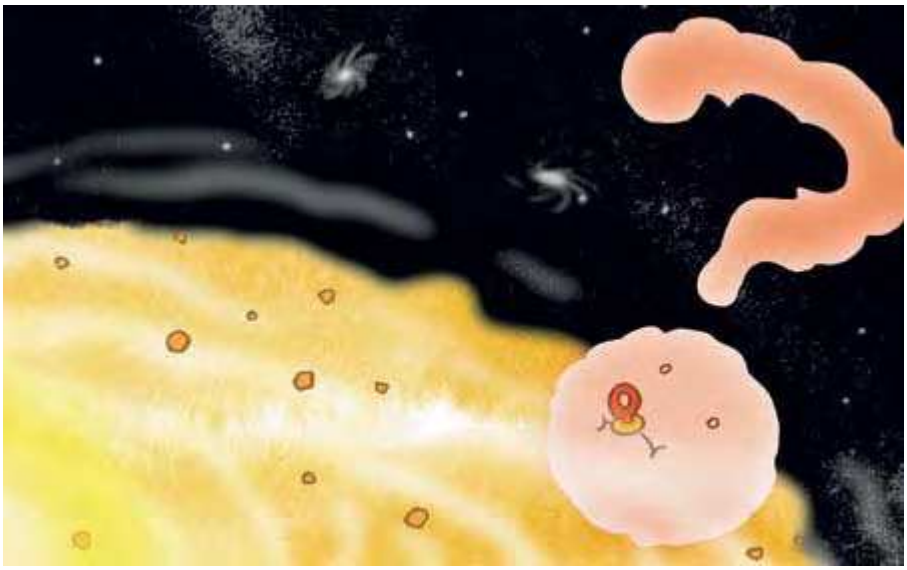
Planetary science

When a world is born

Oct 12th 2006
From The Economist print edition

The discovery of new planets has forced a rethink of how they formed

Illustrations



A WHIRLING, swirling, circumstellar cloud of dust and gas gave birth to the Earth, or so astrophysicists have long believed. But recent discoveries of planets outside the solar system—exoplanets, to give them their proper name—have made scientists suspect that not all such objects can have formed in the same way as the Earth and her neighbours. This insight raises the possibility that the universe contains many more exoplanets than was previously thought.

The first such new world was discovered in 1993 by researchers at Pennsylvania State University. It was thought to be unusual in that the star it orbits is a pulsar—a rapidly rotating, extraordinarily dense neutron star that emits no light. Two years later Michel Mayor and Didier Queloz, of the Geneva Observatory, in Switzerland, spotted a gaseous giant—the same sort of planet as Jupiter, Uranus and Neptune—circling a sun-like star called 51 Pegasi. This exoplanet looked unusual too, because it orbits its host star at a mere twentieth of the distance of the Earth from the sun.

Astronomers have since detected more than 200 exoplanets, and such quirks are no longer novel: in their positioning or in some other respect, most differ substantially from the planets of the solar system. And astronomers hope to see in the differences they observe among exoplanets evidence of differences in the ways these bodies were created.

Astrophysicists generally agree that planets, whether they are small and rocky, like the Earth, or gaseous giants, like most of the exoplanets discovered so far, form from the disc of dust and gas that surrounds a nascent star. Researchers had seen debris discs around exoplanets' host stars, but until recently they had not seen whether the discs and the planets' orbits were aligned. They have now. Astronomers led by Fritz Benedict and Barbara McArthur, of the University of Texas, Austin, examined the Earth's nearest known exoplanet neighbour—a gaseous giant orbiting the sun-like star Epsilon Eridani, 10.5 light years away in the constellation Eridanus. They found that its orbit is inclined at 30 degrees to the Earth's, the same angle at which the star's disc of dust and gas is tilted. The results will appear in the November issue of the *Astronomical Journal*. So far, so good.

Dust to dust

Exactly how gaseous giants emerge from discs of debris, though, is a matter of debate. The accepted wisdom has been that the planets grow from a core of solid material that, once it reaches a critical mass, has enough gravitational pull to attract most of the gas in its orbit. This must happen some distance from the parent star, where conditions are cool enough for sufficient material to be in a solid rather than gaseous form. The so-called ice line, beyond which this happens, is typically three times the distance from the sun to the Earth for sun-like stars.

Most of the exoplanets discovered so far are much closer to their host stars than the ice line. These observations are lending strength to an alternative hypothesis: that the gaseous giants detected so far formed elsewhere and have since spiralled towards the stars they now orbit. This could happen if the material in a protoplanetary disc gradually saps the exoplanet's angular momentum, or if the disc's dust and gas swirls into the star, dragging the exoplanet along with it.

But this is not the only alternative explanation. Another version has it that large and small protoplanetary discs of the same mass may form exoplanets differently. Large discs—like that from which the solar system is thought to have formed—might create gaseous giants farther away from the host star while smaller discs might allow such objects to form closer in.

Unfortunately, the evidence collected so far does not allow astronomers to say which of these ideas, if any, is correct. Earlier this month, for example, the Hubble Space Telescope spotted 16 possible exoplanets closely circling far-flung stars near the centre of the Milky Way. (This is exciting, because it implies that exoplanets are quite common and that there may be as many as 6 billion gaseous giants in the galaxy.) Yet because the host stars are relatively dim, they may not have been hot enough to boil away the building blocks of exoplanets. Or the exoplanets could have migrated there.

Stranger sightings have also been made, which may rewrite theories of planetary formation completely. A month ago astronomers at the Harvard-Smithsonian Centre for Astrophysics announced that they had found a truly exotic exoplanet. The object, dubbed HAT-P-1, is the biggest gaseous giant yet discovered. It orbits one of a pair of stars 450 light years away, in the constellation Lacerta, circling its host every few days. Its distance from this star is only 5% of that between the Earth and the sun. The body's density is extremely low—comparable to that of cork. Moreover, HAT-P-1 is the second exoplanet that is much bigger and less dense than theory predicts. Astrophysicists are baffled as to how such a world could form; a paper describing the discovery has been submitted to the *Astrophysical Journal*.

The discovery of exoplanets in binary and triple-star systems raises the prospect that the galaxy houses many more such objects than was previously thought

This follows the discovery last year by Maciej Konacki, of the California Institute of Technology, of a gaseous giant orbiting a star that is itself orbited by a binary-star system. Such an arrangement would have quickly shed its protoplanetary discs, so how exactly the exoplanet came to be formed is a mystery.

The discovery of exoplanets in binary and triple-star systems raises the prospect that the galaxy houses many more such objects than was previously thought. More than 60% of the stars in the Milky Way have a companion star around which they orbit. Most searches for exoplanets have avoided such systems, because the presence of two stars complicates matters. But given that exoplanets could well form in many different ways, astrophysicists believe that taking a closer look at the neglected majority of double stars may reveal a galaxy full of new worlds.

Finding out just how common exoplanets are—particularly the rocky, Earth-like sort—will be the task of two space-based telescopes to be launched within the next couple of years. All being well, a French spacecraft called COROT, backed by the European Space Agency, will take off in December. It has been designed to spot exoplanets bigger than twice the size of the Earth. America's space agency, NASA, plans to launch a more ambitious exoplanet-hunter, called Kepler, in October 2008. It should be capable of detecting exoplanets smaller than the Earth.

The observatories will monitor regions of the galaxy continuously, in order to detect exoplanets as they pass between their host star and the Earth. The astronomers who will use these telescopes are particularly interested in finding any Earth-like objects in the so-called habitable zone around a star, where temperatures permit water to exist in a liquid state. They hope to detect hundreds of such exoplanets and, in so doing, learn more about how new worlds and even life itself might emerge from

dust and debris.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Conservation

Vaccinate in the vales

Oct 12th 2006
From The Economist print edition

How to protect Ethiopian wolves from rabies

PRUDENT investors learned long ago that putting your eggs into lots of baskets reduces risk. Conservationists have now hit on a similar idea: a population of endangered animals will have a better chance of survival if it is divided into interconnected groups. The prospects of the species will be better because the chance that all the constituent subpopulations will die out at the same time is low. And, in the long term, it matters little if one or two groups do disappear, because immigrants from better-faring patches will eventually re-establish the species' old haunts.

One endangered species divided in just this way is the world's rarest carnivore, the Ethiopian wolf, which lives high in the meadows of the Bale Mountains. Just 350 exist in three pockets of meadow connected by narrow valleys in the Bale Mountains National Park, with a further 150 outside this area.

Two of the main threats to the Ethiopian wolf come from diseases carried by domestic dogs. One of these, rabies, is of particular concern because it is endemic in the dog population. At first blush, vaccinating the wolves against rabies seems a simple solution. It would be ambitious, because the prevailing thinking—that all individuals matter and therefore all outbreaks of disease should be completely halted—implies that a large proportion of wolves would need to be vaccinated.

Dan Haydon, of the University of Glasgow, and his colleagues believe that conservation biologists should think differently. With the exception of humans, species are important but individuals are not. Some outbreaks of disease can be tolerated. In a paper published this week in *Nature*, they recast the mathematics of vaccination with this in mind.

On epidemiologists' standard assumption that every individual counts, vaccination programmes are intended to prevent epidemics by ensuring that each infected animal, on average, passes the disease on to less than one healthy animal. This implies that around two-thirds of all the wolves would need to be vaccinated. A programme that sought to save a species rather than individuals would allow each infected wolf to pass the disease on to more than one healthy animal and hence require fewer vaccinations. Dr Haydon and his colleagues have calculated, using data from a rabies outbreak in 2003, that vaccinating between 10% and 25% would suffice, provided veterinarians gave jabs to those wolves living in the narrow valleys that connect the subpopulations.

If the threat of rabies arose every five years, targeting all the wolves in the corridors would cut the risk of extinction over a 20-year period by fourfold. If this were backed up by vaccinating a mere 10% of the wolves in the three connected meadows, the chance of extinction would drop to less than one in 1,000. Saving a few seems to be an efficient way of protecting the many.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Cancer therapy

Re-establishing control

Oct 12th 2006
From The Economist print edition

The first of a new class of drugs gains regulatory approval

THE 20,000 Americans with a rare cancer called coetaneous T-cell lymphoma have a new treatment. On October 6th the Food and Drug Administration in America approved a drug called Zolinza. In scientific terms, however, it is more than just an alternative to more established medication. Zolinza is one of a new class of drugs that work by switching off genes associated with the development of cancer. Others like it are being developed.

Vorinostat (the generic name for Zolinza) and its cousins alter the way in which cells can turn off large swathes of their genome. One way cells do this naturally is by increasing the packing density of the DNA, the molecules that tell a cell what to do. This is done by removing a chemical tag called an acetyl group from the proteins around which the DNA is coiled. The DNA then becomes so compact that no cell machinery can reach it—and is thus semi-permanently turned off.

In recent years researchers have found that cancer cells have a particular knack for turning off exactly those genes that would normally limit cell growth or cause a damaged cell to commit suicide. In so doing, a tumour cell and its progeny can proliferate when a healthy cell would not. Vorinostat blocks the enzymes that remove the chemical tags and thus releases the DNA from its restrictive packaging, switching back on the genes that were previously silenced. At least, that is the theory.

The facts are a little more complex. When scientists tested the drugs on cancer cells grown in plastic dishes, the drugs affected about 3% of the genes in the genome. They turned on a lot of genes but turned off about as many. Exactly why is unclear. Still, the most important thing is that the regulation of cells is repaired, so that cancer cells die.

Although not all cancer cells respond to this class of drugs, those that make up lymphomas and many leukaemias are very sensitive to it, according to Mark Kirschbaum of the City of Hope National Medical Centre in Duarte, California. Cancerous coetaneous T-cells, which do not normally respond to chemotherapy at all, dropped dead when treated with vorinostat in the laboratory. And, of the 107 patients treated with it in clinical trials, the condition of one-third improved, and their improvement lasted five months. The drug is undergoing clinical trials that test its efficacy against four different blood cancers and lung and prostate cancer.

The trial that gained vorinostat its regulatory approval tested it as a stand-alone treatment, but the new class of drug is likely to improve the outlook for patients when taken with existing cancer therapies, according to Howard Scher of Memorial Sloan-Kettering Cancer Centre in New York. Radiation therapy and many chemotherapy drugs work by damaging the DNA which, in turn, should trigger cell suicide. However, because cancer cells turn off the cell death pathways, they are in effect resistant to these treatments. Experiments on mice suggest that the new drugs reactivate these pathways and restore the tumour cells' sensitivity to DNA-damaging agents. Vorinostat and its cousins are not silver bullets, but they may help polish up some good old-fashioned lead ones.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Altruism

The joy of giving

Oct 12th 2006
From The Economist print edition

Donating to charity rewards the brain

PROVIDING for relatives comes more naturally than reaching out to strangers. Nevertheless, it may be worth being kind to people outside the family as the favour might be reciprocated in future. But when it comes to anonymous benevolence, directed to causes that, unlike people, can give nothing in return, what could motivate a donor? The answer, according to neuroscience, is that it feels good.

Researchers at the National Institute of Neurological Disorders and Stroke in Bethesda, Maryland, wanted to find the neural basis for unselfish acts. They decided to peek into the brains of 19 volunteers who were choosing whether to give money to charity, or keep it for themselves. To do so, they used a standard technique called functional magnetic resonance imaging, which can map the activity of the various parts of the brain. The results were reported in this week's *Proceedings of the National Academy of Sciences*.

The subjects of the study were each given $128 and told that they could donate anonymously to any of a range of potentially controversial charities. These embraced a wide range of causes, including support for abortion, euthanasia and sex equality, and opposition to the death penalty, nuclear power and war. The experiment was set up so that the volunteers could choose to accept or reject choices such as: to give away money that cost them nothing; to give money that was subtracted from their pots; to oppose donation but not be penalised for it; or to oppose donation and have money taken from them. The instances where money was to be taken away were defined as “costly”. Such occasions set up a conflict between each volunteer's motivation to reward themselves by keeping the money and the desire to donate to or oppose a cause they felt strongly about.

Faced with such dilemmas in the minds of their subjects, the researchers were able to examine what went on inside each person's head as they made decisions based on moral beliefs. They found that the part of the brain that was active when a person donated happened to be the brain's reward centre—the mesolimbic pathway, to give it its proper name—responsible for doling out the dopamine-mediated euphoria associated with sex, money, food and drugs. Thus the warm glow that accompanies charitable giving has a physiological basis.

But it seems there is more to altruism. Donating also engaged the part of the brain that plays a role in the bonding behaviour between mother and child, and in romantic love. This involves oxytocin, a hormone that increases trust and co-operation. When subjects opposed a cause, the part of the brain right next to it was active. This area is thought to be responsible for decisions involving punishment. And a third part of the brain, an area called the anterior prefrontal cortex—which lies just behind the forehead, evolved relatively recently and is thought to be unique to humans—was involved in the complex, costly decisions when self-interest and moral beliefs were in conflict. Giving may make all sorts of animals feel good, but grappling with this particular sort of dilemma would appear to rely on a uniquely human part of the brain.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

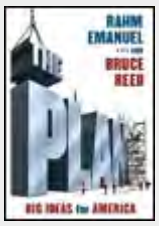
America's mid-term elections

Fighting for votes

Oct 12th 2006
From The Economist print edition

Conflicting advice on how the Democrats can regain power

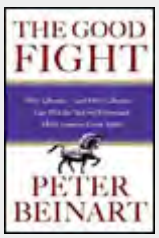
The Plan: Big Ideas for America
By Rahm Emanuel and Bruce Reed



PublicAffairs; 205 pages; $19.95

Buy it at
Amazon.com
Amazon.co.uk

The Good Fight: Why Liberals—and Only Liberals—Can Win the War on Terror and Make America Great Again
By Peter Beinart



HarperCollins; 288 pages; $25.95

Buy it at
Amazon.com
Amazon.co.uk

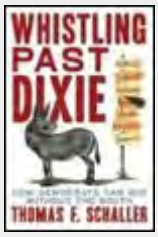
Foxes in the Henhouse: How the Republicans Stole the South and the Heartland and What the Democrats Must Do to Run 'em Out
By Steve Jarding and Dave "Mudcat" Saunders

Simon and Schuster; 307 pages; $24

Buy it at
Amazon.com
Amazon.co.uk

Whistling Past Dixie: How Democrats Can Win Without the South

By Thomas F. Schaller



Simon and Schuster; 323 pages; $26

Buy it at
Amazon.com
Amazon.co.uk

Scandal: How "Gotcha" Politics is Destroying America

By Lanny Davis

Palgrave Macmillan; 288 pages; $24.95 and £15.99

Buy it at
Amazon.com
Amazon.co.uk

Reuters

AS AMERICA'S mid-term elections draw near, Democrats' coffee tables are buckling under a stack of new books telling them how to win back Congress. All lament that George Bush and his Republican Party have wrecked America and much of the rest of the world. But other than that, they agree on little.

The books written by Democratic politicians themselves are mostly disappointing; if you are standing for election, it is hard to be honest and forthright about anything controversial. An exception is “The Plan”, by Rahm Emanuel, one of the smarter young Democratic leaders in the House of Representatives, and Bruce Reed, head of the Democratic Leadership Council, a Clintonian think-tank.

Most of the ideas they espouse are small-bore and sensible—who, besides the army of lobbyists that populates Washington, could be against simplifying the tax code? But they float a few radical notions, too. For example, to make America safer from terrorists and hurricanes, they propose that all young Americans do three months of compulsory training in how to respond to emergencies.

“The Plan” will be taken as a rough blueprint for what the Democrats will do if they capture the House. No such claims can be made for Peter Beinart's “The Good Fight”, but it is worth reading anyway. Mr Beinart, a former editor of the *New Republic* magazine, thinks Democrats need to take more heed of radical Islamism. He likens the party's “Michael Moore” wing, which sees the terrorist threat as a mirage cooked up by Mr Bush to swell Halliburton's profits, to the “doughface” liberals who decried Harry Truman's decision to resist Soviet expansionism after 1945. They “opposed Communism, but would not endorse practical steps to combat it, so as not to implicate themselves in a morally imperfect action.”

Radical Islamism, Mr Beinart argues, really is the new totalitarianism. Its adherents have already killed thousands of Americans, and want to kill more. Mr Beinart supported the invasions of Afghanistan and Iraq, but argues that the aftermath would have been less chaotic had Democrats been in charge. Republicans, he says, are hopeless at nation-building because they don't believe in foreign aid, distrust the UN and think America's righteousness so self-evident that they need not waste time proving it to foreigners.

In the end, though, Mr Beinart fails to stand up his subtitle: “Why Liberals—and Only Liberals—Can Win the War on Terror and Make America Great Again”. He cites the Marshall Plan as an example of liberal nation-building that worked, and suggests trying something similar in the Middle East. He quotes John Kenneth Galbraith, who said that the plan was based “on the shrewd notion that people who are insecure, hungry and without hope are not ardent defenders of liberal institutions or discriminating in the political systems they embrace.” Fair enough. But the plan's European beneficiaries were able to use American loans to build industrialised democracies because they already knew a lot about industry and democracy. Using aid to make today's Middle East more modern is a tougher proposition.

Reading “Foxes in the Henhouse” after Mr Beinart's elegant treatise is like following a plate of *coquilles Saint-Jacques* with a huge rack of over-chillied ribs. Steve Jarding and Dave “Mudcat” Saunders, two consultants, think that if Democrats are to win elections, they need to woo “Bubba”, shorthand for a white, rural and especially Southern working-class voter who has been told by Republicans that “Democrats are nothing but a bunch of anti-gun, anti-God, tax-and-spend wimps.”

To correct this, the authors recommend that Democrats drape themselves in Bubba culture. This is the advice they gave Mark Warner, a Democrat who won the governorship of conservative Virginia in 2001. Mr Warner sponsored a stock-car team, thus linking his name with a sport that a quarter of Americans

adore but which the coastal elite mostly ignore. He put up “Sportsmen for Warner” posters, complete with gun and rod. And he released a bluegrass campaign song with lyrics such as: “So you folks in the mountains at the end of your rope/Get on out and shout it out: Mark is our hope.”

Bubba rules

Messrs Jarding and Saunders think this sort of thing is the key to Democrats taking back the country. Thomas Schaller disagrees. Mr Warner won, he says, largely because an influx of high-tech workers has made Virginia more liberal. In “Whistling Past Dixie”, he argues that Democrats should stop pandering to Southerners and concentrate instead on regions where they are not instantly dismissed as godless baby-killers. By reaching out to voters in the Midwest and libertarian Mountain West, he argues, it should be possible to construct an electoral majority without the South. Besides, the Republicans may “have captured the South but so, too, has the South captured the Republican Party.” This will ultimately benefit the Democrats, he says, because most other Americans are repelled by the excesses of the ultra-religious southern “culture warriors”.

This argument is overstated. Non-Southerners are not as repelled by Republican religiosity as Mr Schaller supposes: only academics and Europeans think America is tottering towards theocracy. And in congressional elections, where so much depends on local issues and candidates' personalities, surely the Democrats should try to pick up seats wherever they can? “Mudcat” Saunders's riposte to Mr Schaller is blunter. Meeting him at a convention, he told him to “kiss my rebel ass”.

Such coarseness would upset Lanny Davis, who laments that American politics has degenerated into a game of “gotcha” between rival teams of “food fight ideologues”. Borrowing a phrase from Bill Clinton, he longs for a return to “vigorous debates where we argue who's right and wrong, not who's good and bad.” Instead, he sees only attack ads and manufactured scandals—from the Republicans' Tartuffery about Mr Clinton's sex life to the Democrats' obsession with proving that Mr Bush “lied” about Iraq, which he calls “a distraction from the much more important issue of how to get out”.

Gotcha politics is not new, of course. But Mr Davis thinks things have got worse since Watergate. That scandal was real, but America reacted to it in a way that made it easier to create bogus ones. First, journalists now report scandals in a “connect-the-dots” fashion, placing events side by side, “implying that they are causally related when there are no facts to show that they are”. Second, independent counsels, created in 1978, go on “prosecutorial fishing expeditions”. Third, new technology, by making news cycles faster, has made reporting less measured. Finally, all this has bred a “culture of public cynicism” where “the benefit of the doubt is no longer freely given”. All true, alas.

The Plan: Big Ideas for America.
By Rahm Emanuel and Bruce Reed.
PublicAffairs; 205 pages; $19.95

The Good Fight: Why Liberals—and Only Liberals—Can Win the War on Terror and Make America Great Again.
By Peter Beinart.
HarperCollins; 288 pages; $25.95

Foxes in the Henhouse: How the Republicans Stole the South and the Heartland and What the Democrats Must Do to Run 'em Out.
By Steve Jarding and Dave “Mudcat” Saunders.
Simon and Schuster; 307 pages; $24

Whistling Past Dixie: How Democrats Can Win Without the South.
By Thomas F. Schaller.
Simon and Schuster; 323 pages; $26

Scandal: How “Gotcha” Politics is Destroying America.
By Lanny Davis.
Palgrave Macmillan; 288 pages; $24.95 and £15.99

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

New fiction: Martin Amis

Comeback man

Oct 12th 2006
From The Economist print edition

THE true critic, Vladimir Nabokov once observed, reads not with his brain but with his backbone. He waits for the “tell-tale tingle down the spine” which alerts him to good writing. After more than a decade messing about writing some fine essays and autobiography mixed in with poor fiction and some questionable history, Martin Amis has suddenly—and unexpectedly, even to his publishers—turned in a work of real worth, a novel that not so much makes the spine tingle as the heart race at its passion and richness.

House of Meetings
By Martin Amis

To be published in America by Knopf in January
Jonathan Cape; 198 pages; £15.99

Buy it at
Amazon.com
Amazon.co.uk

The enemies of the people whom the Soviet authorities sent to camps in the gulag were, on rare occasions, permitted conjugal visits. Valiant women would travel huge distances, the jacket sleeve says, sometimes for weeks or even months, in the hope of spending a night *à deux* in the House of Meetings. Written as a deathbed letter to a well-fed daughter now living in the West, “House of Meetings” tells the tale—and tragic consequences—of one such encounter.

Two brothers fall in love with the same girl, Zoya, a 19-year-old Jewess, in a Moscow that is readying for a pogrom some time between the second world war and the death of Stalin. She marries Lev, the younger. “My little brother came to the camp in 1948,” the story begins. “I was already there.”

The camp is situated just north of the 69th parallel, inside the Arctic circle. As Zoya makes the journey from Moscow, it is the narrator's job to prepare the House of Meetings for Lev and his bride. They had been married for eight years, but this would be their first night together as man and wife. The narrator offers them a thermos of vodka, two candles and six cigarettes (“rolled out of the state newspaper”). The triangular romance, however, is but a come-hither to the novel's weightier themes, which are all about rust, ruin and decay—all metaphors for ageing.

The compulsive vividness of Mr Amis's style may have annoyed his father, but he puts it to good use here. Lev's features seem to have been “thrown together inattentively, as if in the dark. Even his ears seemed to belong to two completely different people.” A smoker, he eats with a cigarette in the hand that holds the knife: “When he went to stub it out, the movement was but a step on the road to lighting another.” There is little romance in the book. The sex, when it appears, comes as a shock. Mr Amis uses it to explore how people are not strengthened by adversity but warped, crushed and then killed, even as they still walk the streets.

“House of Meetings” is a singular, unimpeachable triumph, as powerful as J.M. Coetzee's “Disgrace” and the small list of novels that have unanimously carried off the Man Booker prize for fiction. In the week that a divided jury awarded the 2006 prize to Kiran Desai's “The Inheritance of Loss”, what is astonishing is that Mr Amis's publishers did not even submit his book for consideration.

House of Meetings.
By Martin Amis.
Jonathan Cape; 198 pages; £15.99
To be published in America by Knopf in January

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Sandy Weill

Big man's shoes

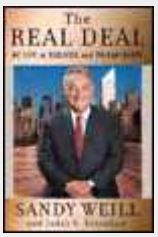
Oct 12th 2006
From The Economist print edition

IN HIS introduction to “The Real Deal”, Sandy Weill's co-author, Judah Kraushaar, a former research analyst, describes Mr Weill as “the single most important figure in the financial services industry over the past half century”. Maybe. But the legacy of the man behind the creation of Citigroup, the world's largest financial institution, and its boss until 2003, is still far from clear.

His story is certainly compelling. Starting in 1960 with $30,000—some of it borrowed from his family, which had thrived during the Depression by mass-producing mourning dresses—Mr Weill built a securities business and sold it to American Express for almost $1 billion in 1981. After taking a year off to deal with a “mid-life crisis” he returned to the fray as head of a small finance company, Commercial Credit. This he expanded through a series of acquisitions into Travelers, a big insurer.

In 1997 Travelers shocked the financial world by acquiring Salomon Brothers, one of Wall Street's best-known banks. But Mr Weill's biggest moment came a year later when he persuaded Citicorp, banking's 800-pound gorilla, to tie the knot. The deal was not only the biggest combination in American corporate history; it also helped to demolish the legal walls that had prevented commercial bankers and investment bankers from encroaching on each other's territory.

The Real Deal: My Life in Business and Philanthropy
By Sandy Weill and Judah S. Kraushaar



Warner Business; 544 pages; $32

Buy it at
Amazon.com
Amazon.co.uk

Mr Weill's description of Citigroup's birth reveals a man desperate to be revered as the architect of an industry-changing merger. When the media flooded into the press conference and cameras started flashing, he recalls, he felt like a rock star.

Mr Weill's love of deals bordered on the addictive. He leapt at the chance to buy Salomon, despite having earlier likened the firm to a casino. During the 1990s he instigated merger talks with, among others, JPMorgan, Merrill Lynch and Goldman Sachs, all to no avail. While still trying to digest Citicorp, he changed his tune on the cultural difficulties of merging with foreign rivals and pushed for a tie-up with Deutsche Bank. He was always happier doing deals than making them work.

Although Mr Weill inspired great loyalty among colleagues, some of his closest relationships ended in rancour. His bloodiest falling-out was with Jamie Dimon, his long-time protégé, who grew too big for his boots and refused to work with colleagues outside a small coterie of investment bankers. Things got so bad that he would schedule key divisional meetings on days when Mr Weill was out of town. Deeply hurt by the snubs, Mr Weill eventually pushed him out, and the two have rarely spoken since. Relations between the intuitive Mr Weill and his more analytical Citigroup co-chief executive, John Reed, also soured. As Mr Reed put it to his partner: “I see the merger as an evolution while you're only focused on the moment.”

But the regulators were to prove even more troublesome than Citi's internal bust-ups. In the book's juiciest section, Mr Weill describes how events began spiralling out of control after the internet mania of the 1990s subsided, exposing sharp practice across Wall Street. Citi was targeted by Eliot Spitzer, New York's attorney-general, and eventually settled for $400m. Mr Weill was also investigated, though no charges were brought. He still seems unsure what to make of it all, saying he understood the need for an investigation while branding Mr Spitzer's approach the “new McCarthyism”.

The stress of the investigation overwhelmed him, he says, just as he was being honoured at an awards ceremony as CEO of the year. Having just watched one of his research analysts bungle his testimony

before a congressional committee, Mr Weill messed up his own speech, sweating buckets as he squirmed. One almost feels a tinge of sympathy.

Mr Weill says this harrowing episode taught him a valuable lesson: that risks to reputation are just as important as day-to-day financial risks. He admits to other mistakes, too. He was not good at confronting people, especially those who had helped him build Travelers. (He found it much easier to criticise colleagues who had come from Salomon and Citicorp.) He had a weakness for picking two “co-heads” to run each department, having seen this formula work well at Goldman Sachs. It rarely worked well at his own firm.

Nevertheless, Mr Weill also indulges in plenty of self-congratulation: over Citigroup's (admittedly impressive) long-term share-price performance, the smooth handover of power in 2003, his rapport with the firm's brokers, and much more. That he survived, and mostly thrived, at the top of such a cut-throat industry for so long is, of course, to his credit. And in the hands of Chuck Prince, his successor, Citigroup remains a hugely powerful beast, albeit one that is struggling to stay at the head of the pack. But as this book inadvertently makes clear, Mr Weill will be remembered as being better at building his business than controlling it.

The Real Deal: My Life in Business and Philanthropy.
By Sandy Weill and Judah S. Kraushaar.
Warner Business; 544 pages; $32

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Hewlett-Packard

Her story

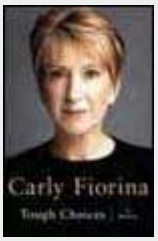
Oct 12th 2006
From The Economist print edition

THE timing of “Tough Choices” ought to be vindication enough for Carly Fiorina. In her glory days, Ms Fiorina spent six years as *Fortune* magazine's “most powerful woman in business” and led her company, Hewlett-Packard, through the largest and most controversial merger in the technology industry. Then, in February 2005, she was fired by the board that had betrayed her.

Twenty months later, her account of these events hits the shelves just as that same board is self-destructing. Patricia Dunn, the woman who replaced Ms Fiorina as chairman, stands accused of felonies in a hunt to find leakers on the board and last month resigned. Other board members have been snooped on, resigned in protest, and shown to be leakers. Senior executives have left in disgrace. All this notwithstanding, HP's numbers have been looking good, almost certainly in part because Ms Fiorina had laid a good foundation.

“Tough Choices” is certain to be a hit, but does the book deserve praise? It is an awkward amalgam of three books in one. Two are superb, but the third spoils the fun.

Tough Choices: A Memoir
By Carly Fiorina



Portfolio; 336 pages; $24.95.
Nicholas Brealey; £16.99

Buy it at
Amazon.com
Amazon.co.uk

Ms Fiorina is at her best when recounting the travails of a woman in a male-dominated business culture. One cringes as she relives a meeting, early in her career, with a male boss and customers at a notorious strip club, where even the staff girls were too embarrassed to do their table dances until she had left. Again and again, Ms Fiorina stared at and even shouted at the misogynists. She was tired of being “grinfucked”, she yelled at one man she believed was trying to do her down. “What's grinfuck mean?” he asked in bafflement at the term, even as he began to respect her for standing up to him. For another meeting, she padded her crotch with her husband's socks, the better to deliver the line “Our balls are as big as anyone's,” to hoots of approval.

Ms Fiorina is also good in her psychological descriptions of the constant betrayals that occur in corporate bureaucracies. The woman that emerges from these pages is cultured, sensitive and vulnerable, even as she acts tough. “To this day I underestimate people's capacity to abuse my trust and the insecurity that sometimes drives them.” She gives only glimpses of her wily, ruthless side. “I sat and watched him self-destruct,” she recalls about one meeting with a rival and their common boss.

Her bigger theme is leadership, and this is where Ms Fiorina fails. Again and again, she interrupts a good narrative with vain and verbose harangues about corporate strategy. From one paragraph to the next, her language becomes wooden and clichéd as she descends into meaningless jargon. Things such as “frameworks” are constantly being “leveraged”, usually “proactively” and “going forward”. Like most former chiefs in search of redemption, Ms Fiorina wants to be remembered as a corporate philosopher. She won't be. But she will be remembered more fondly than she thought.

Tough Choices: A Memoir.
By Carly Fiorina.
Portfolio; 336 pages; $24.95.
Nicholas Brealey; £16.99

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Diego Velázquez

His unflinching eye

Oct 12th 2006
From The Economist print edition

Velázquez excelled at blurring the boundaries between illusion and reality

IN 1914, a suffragette in London's National Gallery, affronted by what seemed to be an immodest representation of womanhood, attacked a painting of a reclining naked Venus. It is rare for Venus to be seen from behind, and only Velázquez has painted her as a brunette. As the suffragette suspected, might she indeed be a real woman? Sacred or profane, there is always more than meets the eye in the paintings of Diego Velázquez.

National Portrait Gallery

Domestic goddess

Just how Velázquez learned his technique of smudging reality and illusion remains a mystery. Now a new exhibition—the biggest in a generation—offers viewers a chance to study the conundrum anew.

Born in Seville in 1599, Velázquez began painting everyday scenes known as *bodegones*. His first important work, “Kitchen Scene with Christ in the House of Martha and Mary” is two pictures in one. It relates the New Testament story of Christ's visit, in which Mary Magdalene sits at his feet and Martha complains that she is doing all the work. Christ admonishes her for being “troubled about many things” and praises Mary for extolling the life of the spirit. A scowling scullery maid pounds garlic in the foreground, suggesting that the artist has some sympathy for her lot. Here is the first instance of the optical device that Velázquez would later make famous, contrasting the active and contemplative life with the toiling maid and the mini-picture (seen through what appears to be a serving hatch) of Christ and the two sisters. It allows the artist to depict different levels of reality, possibly occurring simultaneously, or perhaps as a contrast of real and imagined, present and past.

When he moved to the court in Madrid in 1623, Velázquez employed this device again in his portrait of the *infante*, Baltasar Carlos. The young prince on horseback is in the foregound, while the king is a small distant figure. The king's majesty is so great he does not need to be shown big; the eye will always go to him. In a clear case of reverse snobbery, it is understatement that indicates his importance.

Velázquez was an expert strategist. As court painter (and ultimately curator of the royal collections), he knew that no new painter could outshine the royal masterpieces by Titian, Tintoretto and Rubens. So he did not even try. Instead he realised that the very ambiguity of his pictures would encourage the viewers'

imagination and hold their gaze. With opulent colour and form, his brushstrokes entice you into believing his paintings are so real that you cannot look away. Yet when the viewer moves closer to see how he did it, the image evaporates into a blur of paint.

“Velázquez was inimitable,” says Dawson Carr, the show's curator. “Seen from afar, the figures seem to be alive, to breathe.” Yet he left no school and even his son-in-law, who inherited his studio, could not recreate his technique.

A model connoisseur and collector, Velázquez's master, King Philip IV, saw how great art could burnish the prestige of the monarchy. He also had the good sense to prize artistic candour over flattery. In the 1640s, the king lost his wife, his heir and had started losing his territories. At least a decade passed before he agreed to sit to Velázquez once more, and his pain shows through in the care-worn, paunchy face of the 1656 portrait.

As the king was aware, his “phlegmatic painter” saw it as his duty to portray what he saw before his eyes with a cool detachment. Michel Foucault, a French philosopher, once called Velázquez's masterpiece, “Las Meninas”, the portrait of King Philip's family, “a representation of representation”. As the current exhibition proves, this statement could apply to most of Velázquez's work.

“Velázquez” is at the National Gallery, London, from October 18th until January 21st. “Velázquez, History Painter” will be at the Prado, Madrid, in autumn 2008

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Anna Politkovskaya

Oct 12th 2006
From The Economist print edition

Anna Politkovskaya, a Russian journalist, was shot dead on October 7th, aged 48

Magnum Photos

SHE was brave beyond belief, reporting a gruesome war and a creeping dictatorship with a sharp pen and steel nerves. It may be a chilling coincidence that Anna Politkovskaya was murdered on Vladimir Putin's birthday, but her friends and supporters are in little doubt that her dogged, gloomy reporting of the sinister turn Russia has taken under what she called his “bloody” leadership was what led to her body being dumped in the lift of her Moscow apartment block.

Miss Politkovskaya's journalism was distinctive. Not for her the waffly, fawning and self-satisfied essays of the Moscow commentariat, nor the pervasive well-paid advertorials. Austere and a touch obsessive, she reported from the wrecked villages and shattered towns of Chechnya, talking to those on all sides and none, with endless patience and gritty determination.

She neither sentimentalised the Chechen rebels nor demonised the Russian conscripts—ill-armed, ill-fed and ill-led—who have crushed the Chechens' half-baked independence. She talked to soldiers' mothers trying to find their sons' corpses in military morgues where mangled bodies lay unnamed and unclaimed—the result of the Russian army's unique mixture of callousness and incompetence. And she talked to Chechens whose friends and relatives had disappeared into the notorious “filtration camps” to suffer torture, mutilation, rape and death.

Few journalists, from any country, did that. The second Chechen war, which started in 1999 and still fizzles on now, made that mountainous sliver of territory in the northern Caucasus the most dangerous place on the planet for a journalist. Most Moscow-based reporters went seldom, if at all, and then only in daylight and well-guarded. Ms Politkovskaya was unfazed, making around 50 trips there, often for days at a time.

Ordinary Chechens, and many Russians, adored her. Piles of post and incessant phone calls came, some offering information, more often wanting her help. Could she intercede with a kidnapper? Trace a loved one? She always tried, she said, to do what she could.

She loathed the warlords who had misruled Chechnya during its brief spells of semi-independence; the Islamic extremists who exploited the conflict; the Russian goons and generals, and their local collaborators. She despised the Chechen leaders installed by Russia: they looted reconstruction money, she said, using torture and kidnapping as a weapon. She was due to file a story on this the day she died.

The worst effect of the Chechen wars, she reckoned, was on Russia itself. Her reporting from all over her native country made her see it in what many regarded as an unfairly bleak light. Mr Putin's regime was utterly brutal and corrupt, she would say in her soft, matter-of-fact voice. He represented the worst demons of the Soviet past, revived in modern form. Hundreds had died to bring him to power, and that was just a foretaste of the fascism and war that was to come. Now her pessimism seems less extreme.

A duty to tell

Mr Putin, condemning her murder four days late, said she had “minimal influence”. Yet Miss Politkovskaya was often threatened with death. Once Russian special forces held her captive and threatened to leave her dead body in a ditch. She talked them out of it. In 2001, she fled briefly to Austria after a particularly vivid death threat scared not her, but her editors at *Novaya Gazeta*, one of Russia's few remaining independent papers. In 2004, on her way to the siege of a school in the North Ossetian town of Beslan, where she hoped to mediate between the Chechen hostage-takers and the Russian army, she was poisoned and nearly died.

This time there was no mistake. She was shot in the body and the head. A pistol was left by her side—the blatant hallmark of a contract killing. She was well aware that the authorities might have her murdered, but in conversation she would brush this aside, saying that her sources were in much more danger than she was. Journalists had a duty to report on the subject that mattered, she said, just as singers had to sing and doctors had to heal.

Much of her life mirrored the changes in her country. She was born in New York, the child of Soviet diplomats. That gilded upbringing gave her access to a world of ideas and knowledge denied to most Soviet citizens. Her university dissertation was on Marina Tsvetaeva, a poet then in deep official disfavour. She had good jobs too, first on *Izvestia*, the government paper, then on Aeroflot's in-flight magazine.

Having discovered democracy and the free press as Soviet power collapsed, her faith was uncompromising and sometimes uncomfortable. Nor was she always easy company. A fondness for both sweeping statements and intricate details sometimes made conversation heavy-going. She was both disorganised and single-minded; that could be unnerving, too. But she enjoyed life. She often said that with a KGB officer as president, the least you could do was to smile sometimes, to show the difference between him and you.

It would be nice to think that Russians will find her example inspiring. Sadly, they may conclude that brave work on hot topics is a bad idea.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Overview

Oct 12th 2006
From The Economist print edition

In **America** the federal budget deficit shrank to $247.7 billion in the 2006 fiscal year (which ended on September 30th) from $318.7 billion the year before. Rising income, payroll and corporate tax receipts helped narrow the gap.

Hiring in America slowed, as companies, excluding farms, added just 51,000 workers to their payrolls in September. Nonetheless, unemployment edged down from 4.7% in August to 4.6% in September. And the Bureau of Labour Statistics is expecting a big upward revision in its payroll numbers. It estimates that an additional 810,000 non-farm jobs were created in the year to March.

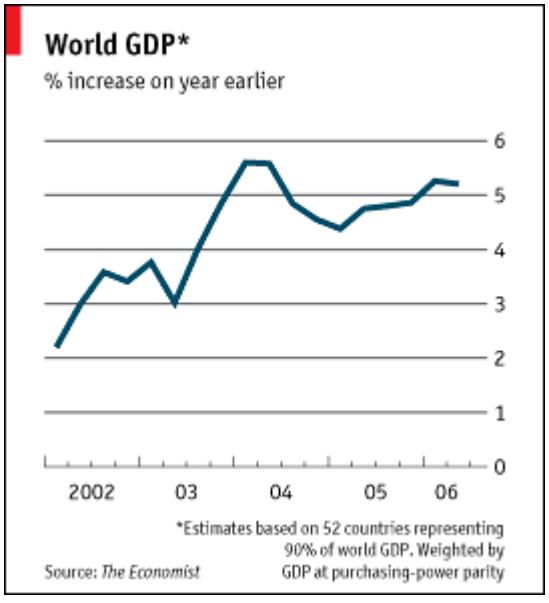
Machinery orders in **Japan** picked up in August after a dreadful July. Core orders, which exclude those for ships and from electricity companies, rose by 6.7% in August, after dropping by 16.7% in July. The increase was weaker than expected, because of a struggling car industry, but was lifted by production of semiconductor equipment.

Industrial production in **Germany** rose by 7.3% in the year to August, the largest annual increase since 1990. In **France** it went up by 1%. Germany's merchandise-trade surplus, seasonally adjusted, grew to €12.1 billion ($15.5 billion) in August.

Stockmarkets in **Brussels**, **Madrid** and **Zurich** set record highs this week, as did **New York's** Dow Jones Industrial Average.

Britain's merchandise trade deficit narrowed to £6.73 billion ($12.8 billion) in August, from £6.79 billion in July.

World output increased by 5.2% in the year to the second quarter.



Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Output, demand and jobs

Oct 12th 2006
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2006	2007	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 1.9	Q2	+ 1.3	+ 2.7	+ 3.2	– 1.0	Q1	+ 3.6	Q2	4.8	Sep	5.1
Austria	+ 3.0	Q2	+ 3.6	+ 2.6	+ 2.0	+ 7.9	Jul	+ 2.2	Jul	4.8	Sep	5.2
Belgium	+ 2.8	Q2	+ 3.1	+ 2.6	+ 2.0	+ 3.7	Jul	+ 1.6	Jul	13.0	Jul†	13.4
Britain	+ 2.6	Q2	+ 2.8	+ 2.6	+ 2.4	+ 0.7	Aug	+ 4.3	Aug	5.5	Jul‡	4.7
Canada	+ 2.9	Q2	+ 2.0	+ 2.9	+ 2.6	+ 0.7	Jul	+ 5.5	Jun	6.4	Sep	6.7
Denmark	+ 2.8	Q2	+ 6.5	+ 2.7	+ 2.1	+ 4.3	Aug	+ 3.8	Aug	4.4	Aug	5.7
France	+ 2.6	Q2	+ 4.9	+ 2.3	+ 2.0	+ 1.0	Aug	+ 3.6	Aug	9.0	Aug	9.9
Germany	+ 2.4	Q2	+ 3.6	+ 2.3	+ 1.3	+ 7.3	Aug	+ 1.0	Aug	10.6	Sep§	11.7
Italy	+ 1.5	Q2	+ 2.2	+ 1.6	+ 1.2	+ 3.5	Aug	– 0.7	Jul	7.0	Q2	7.8
Japan	+ 2.5	Q2	+ 1.0	+ 2.8	+ 2.1	+ 6.0	Aug	+ 0.3	Aug	4.1	Aug	4.3
Netherlands	+ 2.8	Q2	+ 4.8	+ 2.7	+ 2.2	+ 1.9	Jun	+ 4.6	Jun	5.4	Aug††	6.6
Spain	+ 3.7	Q2	+ 3.8	+ 3.5	+ 2.8	+ 5.0	Aug	+ 4.1	Aug	7.8	Aug	8.6
Sweden	+ 5.1	Q2	+ 5.4	+ 4.4	+ 3.0	+ 7.0	Aug	+ 8.0	Aug	5.7	Aug†	6.5
Switzerland	+ 3.2	Q2	+ 3.0	+ 3.0	+ 2.0	+ 4.3	Q2	+ 2.1	Jul	3.1	Sep†	3.6
United States	+ 3.5	Q2	+ 2.6	+ 3.4	+ 2.4	+ 4.7	Aug	+ 4.8	Aug	4.6	Sep	5.1
Euro area	+ 2.7	Q2	+ 3.8	+ 2.5	+ 1.8	+ 3.2	Jul	+ 2.4	Aug	7.9	Aug	8.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 6.6	Q2	+ 7.6	na	na	+ 7.6	Aug	+ 5.5	Aug	7.8	Aug	8.2
Greece	+ 4.1	Q2	na	na	na	+ 2.3	Aug	+10.7	Jul	8.8	Q2	9.6
Iceland	+ 2.8	Q2	na	na	na	na		na		1.4	Jul†	2.0
Ireland	+ 5.0	Q2	+ 3.6	na	na	+ 8.4	Jul	+ 5.5	Jul	4.4	Sep	4.4
Luxembourg	+ 5.4	Q2	na	na	na	– 2.7	Jun	+ 2.3	Aug	4.1	Aug	4.1
New Zealand	+ 1.6	Q2	+ 1.7	na	na	+ 0.5	Q2	+ 0.9	Q2	3.6	Q2	3.7
Norway	– 0.5	Q2	+ 1.9	na	na	– 2.7	Aug	+ 5.0	Aug	3.0	Aug††	4.8
Portugal	+ 0.9	Q2	+ 3.8	na	na	+ 5.1	Aug	+ 2.5	Aug	7.3	Q2†	7.2

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡May-Jul; claimant count rate 3.0% in Aug. §EU harmonised rate 8.5% in Aug. ††Jun-Aug.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Prices and wages

Oct 12th 2006
From The Economist print edition

% change on year ago

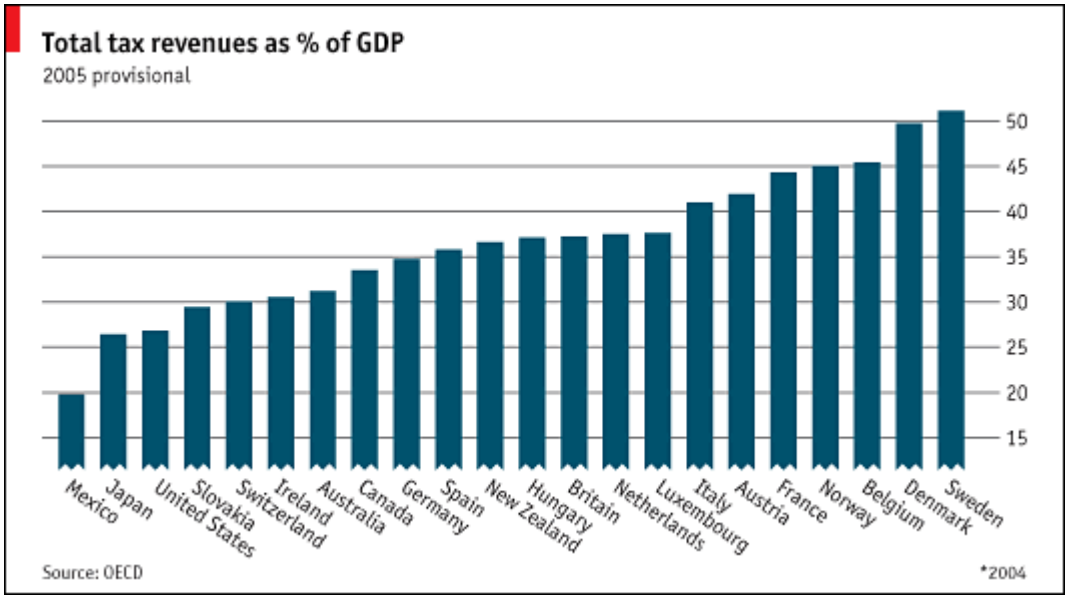
	Consumer prices latest		Consumer prices year ago	The Economist poll consumer prices forecast 2006	The Economist poll consumer prices forecast 2007	Producer prices latest		Producer prices year ago	Wages/earnings latest		Wages/earnings year ago
Australia	+ 4.0	Q2	+ 2.5	+ 3.4	+ 2.8	+ 9.9	Q2	+ 6.9	+ 4.7	Q2	+ 5.8
Austria	+ 1.8	Aug	+ 2.0	+ 1.8	+ 1.7	+ 2.4	Sep	+ 1.5	+ 2.7	Aug	+ 2.3
Belgium	+ 1.2	Sep	+ 3.2	+ 2.0	+ 1.9	+ 5.9	Aug	+ 1.7	+ 2.1	Jul	+ 2.5
Britain	+ 2.5	Aug*	+ 2.4	+ 2.3	+ 2.2	+ 1.8	Sep	+ 3.3	+ 4.4	Jul†	+ 4.1
Canada	+ 2.1	Aug	+ 2.6	+ 2.4	+ 2.2	+ 3.6	Aug	– 0.3	+ 1.4	Jul	+ 0.4
Denmark	+ 1.5	Sep	+ 2.4	+ 2.0	+ 2.0	+ 4.3	Aug	+ 5.0	+ 3.2	Q2	+ 2.9
France	+ 1.9	Aug	+ 1.8	+ 2.0	+ 1.7	+ 3.9	Jul	+ 3.3	+ 3.1	Q2	+ 3.0
Germany	+ 1.0	Sep	+ 2.5	+ 1.8	+ 2.3	+ 3.0	Sep	+ 3.6	– 0.5	Jul	+ 1.3
Italy	+ 2.2	Sep	+ 2.0	+ 2.2	+ 2.0	+ 6.6	Aug	+ 3.7	+ 2.9	Aug	+ 2.9
Japan	+ 0.9	Aug	– 0.3	+ 0.3	+ 0.5	+ 3.4	Aug	+ 1.8	– 0.6	Aug	– 2.7
Netherlands	+ 1.1	Sep	+ 1.8	+ 1.6	+ 1.7	+ 4.9	Aug	+ 5.1	+ 2.0	Sep	+ 0.8
Spain	+ 2.9	Sep	+ 3.7	+ 3.8	+ 3.0	+ 5.7	Aug	+ 4.9	+ 3.1	Q2	+ 3.4
Sweden	+ 1.5	Sep	+ 0.6	+ 1.4	+ 1.9	+ 3.9	Aug	+ 4.2	+ 2.5	Jul	+ 2.9
Switzerland	+ 0.8	Sep	+ 1.4	+ 1.3	+ 1.3	+ 3.1	Aug	+ 1.0	+ 1.0	2005	+ 0.9
United States	+ 3.8	Aug	+ 3.6	+ 3.5	+ 2.4	+ 3.7	Aug	+ 5.3	+ 4.0	Sep	+ 2.7
Euro area	+ 1.8	Sep	+ 2.6	+ 2.2	+ 2.1	+ 5.7	Aug	+ 4.0	+ 2.4	Q2	+ 2.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.9	Aug	+ 1.0	na	na	+ 6.3	Aug	+ 3.8	+ 2.9	Q2	+ 3.7
Greece	+ 2.9	Sep	+ 3.9	na	na	+ 6.7	Aug	+ 5.5	na		na
Iceland	+ 7.2	Oct	+ 4.6	na	na	+11.4	Sep	+ 4.6	+10.6	Aug	+ 6.7
Ireland	+ 4.5	Aug	+ 2.3	na	na	+ 0.9	Aug	– 1.1	+ 2.2	Q1	+ 6.4
Luxembourg	+ 2.4	Sep	+ 2.9	na	na	+10.4	Jul	+ 5.5	+ 2.4	Jul	+ 0.9
New Zealand	+ 4.0	Q2	+ 2.8	na	na	+ 7.8	Q2	+ 4.7	+ 3.3	Q2	+ 2.6
Norway	+ 2.6	Sep	+ 2.0	na	na	+ 5.0	Sep	+17.9	+ 3.6	Q2	+ 3.8
Portugal	+ 2.0	Aug	+ 2.6	na	na	+ 4.9	Aug	+ 4.4	+ 1.1	Aug	+ 0.5

*RPI inflation rate 3.4% in Aug. †May-Jul.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Total tax revenues as % of GDP

Oct 12th 2006
From The Economist print edition



The era of big government continues. Last year the state claimed a bigger share of the economy than in the year before in 17 of the 24 members of the OECD for which 2005 data are available. Only in Austria, Hungary, Italy, Luxembourg and Slovakia did tax revenues fall as a share of GDP. Sweden's government claims over half of the economy's output; Mexico's grabs less than a fifth.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Money and interest rates

Oct 12th 2006
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Oct 11th 2006)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+10.2	+11.2	Aug	6.23	5.62	5.91	5.61	5.37	6.80
Britain	+ 5.0	+13.7	Aug	5.06	4.50	5.00	4.60	4.32	5.67
Canada	+13.6	+ 6.9	Aug	4.16	2.94	4.06	4.13	4.04	5.16
Denmark	+ 8.2	+ 7.4	Aug	3.64	2.20	3.74	3.77	3.15	5.13
Japan	+ 1.5	+ 0.6	Sep	0.34	0.02	0.70	1.73	1.53	1.91
Sweden	+ 0.1	+13.7	Aug	2.61	1.52	3.37	3.71	3.14	3.88
Switzerland	– 1.3	+ 1.9	Aug	1.84	0.80	1.99	2.43	1.89	2.57
United States	– 0.6	+ 4.7	Aug	5.31	3.85	4.86	4.78	4.44	5.71
Euro area†	+ 7.2	+ 8.2	Aug	3.49	2.19	3.67	3.76	3.19	4.42

*Narrow: M1 except Britain notes and coin and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. ‡Sep 27th. Benchmarks: US 30-year 4.88%, Japan No. 282 1.74%. Central bank rates: US fed funds 5.25%, ECB refinancing 3.00%, BOJ overnight call 0.25%, BOE repo 4.75%. Sources: Bank of Canada, Commerzbank, Danske Bank, Global Insight, JPMorgan Chase, Lehman Brothers, Stockholmsbörsen, UBS, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The Economist commodity price index

Oct 12th 2006
From The Economist print edition

2000=100

	Oct 3rd	Oct 10th*	% change on one month	% change on one year
Dollar index				
All items	172.5	177.3	+ 4.0	+ 30.9
Food	136.5	141.4	+ 6.5	+ 13.7
Industrials				
All	219.1	223.7	+ 2.1	+ 49.2
Nfa†	136.4	135.8	– 2.2	– 0.1
Metals	264.3	271.7	+ 3.3	+ 72.4
Sterling index				
All items	138.5	144.9	+ 5.2	+ 23.1
Euro index				
All items	125.2	130.7	+ 5.3	+ 25.1
Yen index				
All items	188.7	196.8	+ 5.7	+ 36.8
Gold				
$ per oz	582.50	574.00	– 3.3	+ 20.5
West Texas Intermediate				
$ per barrel	58.65	58.50	– 8.2	– 7.9

*Provisional. †Non-food agriculturals.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Stockmarkets

Oct 12th 2006
From The Economist print edition

Market indices

	Oct 11th	2006 high	2006 low	% change on one week	% change on record high	% change on Dec 30th 2005 in local currency	% change on Dec 30th 2005 in $ terms
Australia (All Ordinaries)	5,245.3	5,318.2	4,708.8	+ 2.8	– 1.4	+11.4	+13.1
Austria (ATX)	3,914.1	4,344.4	3,324.1	+ 3.7	– 9.9	+ 6.7	+13.6
Belgium (Bel 20)	4,129.3	4,129.3	3,445.1	+ 1.1	nil	+16.3	+23.8
Britain (FTSE 100)	6,073.5	6,132.7	5,506.8	+ 1.8	– 12.4	+ 8.1	+16.9
Canada (Toronto Composite)	11,619.1	12,487.3	10,904.3	nil	– 7.0	+ 3.1	+ 6.0
Denmark (OMXCB)	387.8	395.5	325.0	+ 1.9	– 1.9	+ 5.4	+12.2
France (SBF 250)	3,740.1	3,755.6	3,244.2	+ 1.1	– 14.8	+13.3	+20.5
France (CAC 40)	5,313.2	5,313.2	4,615.4	+ 1.1	– 23.2	+12.7	+19.9
Germany (DAX)*	6,119.5	6,140.7	5,292.1	+ 1.2	– 24.1	+13.2	+20.4
Italy (S&P/MIB)	39,489.0	39,489.0	34,850.0	+ 2.0	– 21.2	+10.6	+17.7
Japan (Nikkei 225)	16,400.6	17,563.4	14,218.6	+ 2.0	– 57.9	+ 1.8	+ 0.5
Japan (Topix)	1,622.1	1,783.7	1,458.3	+ 1.3	– 43.8	– 1.7	– 3.0
Netherlands (AEX)	490.0	490.0	412.9	+ 1.2	– 30.2	+12.2	+19.3
Spain (Madrid SE)	1,443.5	1,443.5	1,156.8	+ 2.0	nil	+24.8	+32.8
Sweden (Affarsvarlden Gen)	336.4	336.4	275.2	+ 2.7	– 16.0	+14.6	+23.6
Switzerland (Swiss Market)	8,638.0	8,638.0	7,154.9	+ 2.2	nil	+13.9	+18.2
United States (DJIA)	11,852.1	11,867.2	10,667.4	nil	– 0.1	+10.6	+10.6
United States (S&P 500)	1,350.0	1,353.4	1,223.7	nil	– 11.6	+ 8.1	+ 8.1
United States (NASDAQ Comp)	2,308.3	2,370.9	2,020.4	+ 0.8	– 54.3	+ 4.7	+ 4.7
Europe (FTSEurofirst 300)†	1,425.4	1,425.4	1,238.7	+ 1.6	– 16.4	+11.7	+18.9
Euro area (FTSE Euro 100)†	1,222.0	1,222.0	1,050.0	+ 1.5	– 21.2	+12.2	+19.4
World (MSCI)‡	1,385.2	1,406.3	1,243.9	+ 0.3	– 4.4	+10.1	+10.1
World bond market (Citigroup)††	638.7	653.7	612.1	– 1.4	– 4.2	+ 3.0	+ 3.0

*Total return index. †In euro terms. ‡Morgan Stanley Capital International index includes individual markets listed above plus eight others, in $ terms. ††Citigroup World Government Bond Index, total return, in $ terms.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Trade, exchange rates and budgets

Oct 12th 2006
From The Economist print edition

	Trade balance*, $bn latest 12 months	Current-account balance $bn latest 12 mths	Current-account balance The Economist poll % of GDP, forecast 2006	Current-account balance The Economist poll % of GDP, forecast 2007	Exchange rate trade-weighted† 2000=100 Oct 11th	Exchange rate trade-weighted† 2000=100 year ago	Currency units per $ Oct 11th	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2006‡
Australia	− 10.6 Aug	− 41.0 Q2	− 5.6	− 5.3	117.1	118.3	1.34	1.33	2.49	1.68	1.12	+ 0.9
Austria	− 1.6 Jul	+ 6.4 Q1	+ 0.8	+ 0.8	105.8§	105.1	0.80	0.83	1.48	–	0.67	− 1.9
Belgium	+ 15.7 Jul	+ 6.5 Jun	+ 1.8	+ 2.0	107.6§	106.8	0.80	0.83	1.48	–	0.67	− 0.4
Britain	−142.0 Aug	− 64.4 Q2	− 2.7	− 3.0	101.5	98.1	0.54	0.57	–	0.68	0.45	− 3.4
Canada	+ 58.8 Jul	+ 28.6 Q2	+ 1.5	+ 1.0	127.3	123.8	1.14	1.17	2.11	1.43	0.95	+ 2.2
Denmark	+ 7.9 Aug	+ 7.0 Aug	+ 1.9	+ 1.8	106.7	105.7	5.94	6.20	11.0	7.46	4.97	+ 3.3
France	− 35.0 Aug	− 36.3 Jul	− 1.8	− 1.4	108.5§	107.5	0.80	0.83	1.48	–	0.67	− 2.9
Germany	+185.9 Aug	+105.5 Aug	+ 3.6	+ 3.6	110.2§	108.9	0.80	0.83	1.48	–	0.67	− 3.1
Italy	− 23.9 Jul	− 34.3 Jul	− 1.8	− 1.7	108.1§	107.1	0.80	0.83	1.48	–	0.67	− 4.2
Japan	+ 78.0 Jul	+166.9 Aug	+ 3.5	+ 3.5	78.9	84.0	120	114	222	150	–	− 5.2
Netherlands	+ 39.0 Jul	+ 46.2 Q2	+ 6.3	+ 6.0	108.5§	107.5	0.80	0.83	1.48	–	0.67	− 0.5
Spain	−104.9 Jul	− 92.6 Jun	− 8.4	− 8.0	105.9§	105.3	0.80	0.83	1.48	–	0.67	+ 1.1
Sweden	+ 19.7 Aug	+ 24.1 Q2	+ 6.5	+ 6.0	98.0	95.8	7.38	7.77	13.7	9.26	6.17	+ 1.7
Switzerland	+ 8.2 Aug	+ 55.3 Q2	+13.0	+12.5	104.5	106.7	1.27	1.29	2.36	1.59	1.06	− 0.2
United States	−839.7 Jul	−838.1 Q2	− 6.6	− 6.6	85.1	86.2	–	–	1.86	1.25	0.84	− 3.6
Euro area	− 20.9 Jul	− 52.3 Jul	− 0.4	− 0.2	118.6	115.8	0.80	0.83	1.48	–	0.67	− 2.3
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 10.9 Jul	+ 11.8 Jul	na	na	109.2§	108.3	0.80	0.83	1.48	–	0.67	+ 2.2
Greece	− 39.5 Jul	− 25.1 Jul	na	na	105.0§	104.3	0.80	0.83	1.48	–	0.67	− 3.0
Iceland	− 1.9 Aug	− 3.4 Q2	na	na	85.6**	100.9	68.6	61.3	127	86.1	57.4	+ 2.0
Ireland	+ 38.1 Jul	− 6.0 Q2	na	na	113.9§	112.4	0.80	0.83	1.48	–	0.67	− 0.3
Luxembourg	− 5.3 Jul	+ 4.2 Q2	na	na	107.6§	106.8	0.80	0.83	1.48	–	0.67	− 1.7
New Zealand	− 4.4 Aug	− 10.2 Q2	na	na	131.6	138.4	1.51	1.44	2.81	1.90	1.26	+ 4.6
Norway	+ 59.8 Aug	+ 56.5 Q2	na	na	104.2	111.9	6.72	6.49	12.5	8.43	5.62	+ 18.5
Portugal	− 22.5 Jul	− 16.7 Jul	na	na	105.9**	105.0	0.80	0.83	1.48	–	0.67	− 5.0

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, August average. ‡OECD forecast. **IMF, June average.

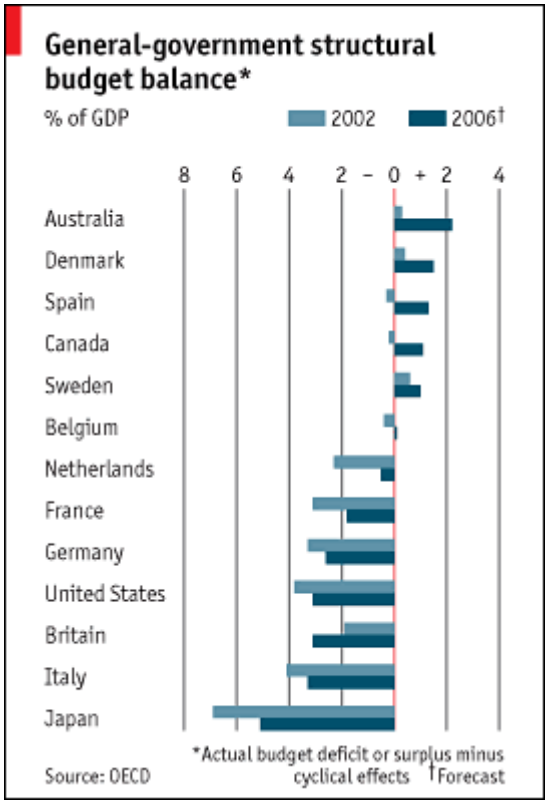
Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

General-government structural budget balance

Oct 12th 2006
From The Economist print edition



Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Overview

Oct 12th 2006
From The Economist print edition

Inflation quickened in **Hungary**, partly because of increases in indirect taxes. Consumer prices rose by 5.9% in the year to September, from 3.5% in the year to August.

In **Brazil** industrial production expanded by 3.2% in the year to August. It grew by 1.2% in **Chile** in the same period.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Bribery

Oct 12th 2006
From The Economist print edition

Bribery has a supply side as well as a demand side. Indian and Chinese companies are the most prolific bribe-payers when doing business abroad, according to Transparency International, an anti-corruption group. Many companies observe a double standard, it notes, paying bribes more freely abroad than at home. The index draws on the views of over 11,000 businessmen, asked to rate foreign firms operating in their country.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economy

Oct 12th 2006
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+11.3	Q2	+15.7	Aug	+ 1.3	Aug	+143.6	Sep	+160.8	2005	954.5	Jul
Hong Kong	+ 5.2	Q2	+ 5.3	Q2	+ 2.5	Aug	−14.9	Aug	+18.6	Q2	130.3	Sep
India	+ 8.9	Q2	+ 9.7	Aug	+ 6.3	Aug	−41.8	Aug	−13.2	Q2	158.3	Sep
Indonesia	+ 5.2	Q2	+12.2	Jul	+14.5	Sep	+36.4	Aug	+ 4.1	Q2	40.8	Sep
Malaysia	+ 5.9	Q2	+ 5.0	Aug	+ 3.3	Aug	+28.0	Aug	+20.0	Q2	79.0	Aug
Pakistan	+ 6.6	2006†	+13.0	Jul§	+ 8.9	Aug	−12.6	Aug	− 5.0	Q2	11.3	Aug
Philippines	+ 5.5	Q2	−10.4	Jul	+ 5.7	Sep	− 4.1	Jul	+ 2.9	Mar	18.8	Sep
Singapore	+ 7.1	Q3	+ 5.5	Aug	+ 0.7	Aug	+32.6	Aug	+38.3	Q2	129.4	Sep
South Korea	+ 5.3	Q2	+10.6	Aug	+ 2.4	Sep	+15.7	Sep	+ 5.8	Aug	227.0	Aug
Taiwan	+ 4.6	Q2	+ 4.8	Aug	− 1.2	Sep	+20.3	Aug	+20.6	Q2	261.6	Sep
Thailand	+ 4.9	Q2	+ 7.4	Aug	+ 2.7	Sep	− 1.9	Aug	+ 3.4	Aug	57.7	Aug
Argentina	+ 7.9	Q2	+ 7.6	Aug	+10.4	Sep	+11.3	Aug	+ 7.4	Q2	25.1	Jul
Brazil	+ 1.2	Q2	+ 3.2	Aug	+ 3.7	Sep	+46.3	Sep	+13.8	Aug	68.8	Aug
Chile	+ 4.5	Q2	+ 1.2	Aug	+ 2.8	Sep	+20.0	Sep	+ 2.2	Q2	17.6	Sep
Colombia	+ 6.0	Q2	+13.6	Jul	+ 4.6	Sep	+ 0.7	Jul	− 2.2	Q2	14.9	Aug
Mexico	+ 4.7	Q2	+ 5.8	Jul	+ 4.1	Sep	− 4.2	Aug	− 0.6	Q2	83.6	Aug
Peru	+ 9.0	Jul	+ 5.6	Jul	+ 2.0	Sep	+ 6.9	Jul	+ 1.3	Q2	14.3	Aug
Venezuela	+ 9.2	Q2	+ 7.8	Jul	+15.3	Sep	+37.2	Q2	+29.5	Q2	27.6	Aug
Egypt	+ 5.9	Q1	+ 4.0	2005†	+ 8.9	Aug	−11.2	Q1	+ 2.1	Q1	22.9	Sep
Israel	+ 6.2	Q2	+13.4	Jul	+ 2.2	Aug	− 7.9	Aug	+ 5.8	Q2	27.8	Sep
Saudi Arabia	+ 6.6	2005‡	na		+ 2.2	Jul	+126.5	2005	+90.7	2005	25.4	Aug
South Africa	+ 3.6	Q2	+ 4.2	Aug	+ 5.4	Aug	− 8.2	Aug	−13.3	Q2	22.3	Sep
Czech Republic	+ 6.2	Q2	+ 7.4	Aug	+ 2.7	Sep	+ 1.7	Aug	− 3.8	Q2	30.4	Sep
Hungary	+ 3.8	Q2	+ 9.0	Aug	+ 5.9	Sep	− 3.1	Aug	− 7.6	Q2	20.8	Aug
Poland	+ 5.5	Q2	+12.5	Aug	+ 1.6	Aug	− 3.2	Jul	− 4.9	Jul	46.7	Aug
Russia	+ 7.4	Q2	+ 5.6	Aug	+ 9.6	Sep	+142.3	Aug	+91.4	Q2	258.7	Sep
Turkey	+ 7.5	Q2	+ 4.8	Aug	+10.6	Sep	−50.6	Aug	−30.1	Aug	58.0	Aug
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+12.0	Q2	+10.6	Aug	+ 3.8	Sep	− 2.9	Jul	− 1.8	Jul	2.2	Jul
Latvia	+10.9	Q2	+ 7.6	Aug	+ 5.9	Sep	− 3.9	Jul	− 2.8	Jul	3.9	Aug
Lithuania	+ 7.7	Q2	na		+ 3.2	Sep	− 4.4	Aug	− 2.4	Jul	4.1	Aug
Slovakia	+ 6.2	Q2	+ 8.3	Jul	+ 4.6	Sep	− 3.0	Jul	− 4.4	Jun	12.5	Aug
Slovenia	+ 4.9	Q2	+10.9	Aug	+ 2.5	Sep	− 1.8	Aug	− 0.6	Jul	7.7	Jul

*Excluding gold, except Singapore and China; IMF definition. †Year ending June. ‡Economist Intelligence Unit estimate. §New series.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Financial markets

Oct 12th 2006
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Oct 11th		Dec 30th 2005	
	Oct 11th	year ago	Oct 11th	% a year		one week	in local currency	in $ terms
China	7.91	8.09	14.7	3.00	1,880.6	+2.2	+ 54.0	+ 57.1
Hong Kong	7.79	7.76	14.5	4.17	17,862.8	+1.3	+ 20.1	+ 19.5
India	45.7	44.8	84.7	6.59	12,353.5	+1.2	+ 31.4	+ 29.6
Indonesia	9,223	10,165	17,120	11.05	1,553.1	+1.0	+ 33.6	+ 42.5
Malaysia	3.70	3.77	6.86	3.81	970.4	+0.7	+ 7.8	+ 10.3
Pakistan	60.6	59.7	113	10.27	10,886.8	+1.3	+ 13.9	+ 12.3
Philippines	50.0	55.8	92.8	7.81	2,527.3	+1.6	+ 20.6	+ 27.9
Singapore	1.59	1.69	2.95	3.39	2,641.6	+1.5	+ 12.5	+ 17.8
South Korea	958	1,043	1,779	4.61	1,325.5	- 2.0	- 3.9	+ 1.4
Taiwan	33.3	33.4	61.8	1.84	7,006.7	+1.9	+ 7.0	+ 5.6
Thailand	37.5	41.0	69.5	5.35	697.8	+1.4	- 2.2	+ 7.0
Argentina	3.11	2.96	5.77	10.13	1,630.1	- 0.7	+ 5.6	+ 2.9
Brazil	2.15	2.23	4.00	14.16	38,322.0	+1.5	+ 14.5	+ 24.2
Chile	537	529	996	5.16	10,900.9	+0.8	+ 18.4	+ 13.0
Colombia	2,389	2,300	4,435	6.22	9,620.2	+2.7	+ 1.1	- 3.2
Mexico	11.0	10.9	20.5	7.06	22,387.1	+1.3	+ 25.8	+ 21.2
Peru	3.24	3.39	6.02	4.42	10,254.4	+3.4	+113.5	+125.8
Venezuela	2,871§	2,659§	5,329	10.00	36,850.4	+2.3	+ 80.7	+ 62.8
Egypt	5.74	5.76	10.65	9.32	55,145.0	- 1.2	- 0.4	- 0.4
Israel	4.27	4.64	7.92	5.59	874.6	+1.7	+ 5.6	+ 14.0
Saudi Arabia	3.75	3.75	6.96	5.24	10,957.9	+1.2	- 34.4	- 34.4
South Africa	7.70	6.56	14.3	8.40	22,679.4	+1.4	+ 25.3	+ 3.2
Czech Republic	22.5	24.6	41.7	2.63	1,471.0	+1.2	- 0.1	+ 9.4
Hungary	213	208	395	8.29	22,505.8	+2.5	+ 8.3	+ 8.8
Poland	3.11	3.23	5.78	4.23	46,340.3	+4.7	+ 30.2	+ 36.2
Russia	26.9	28.6	50.0	11.50	1,585.6‡	+4.2	+ 32.0	+ 40.9
Turkey	1.49	1.36	2.77	20.38	37,660.4	+3.5	- 5.3	- 14.2
EM (MSCI)*	1.00	1.00	1.86	na	785.8	+1.5	+ 11.2	+ 11.2
EMBI+†	1.00	1.00	1.86	na	392.0	- 0.2	+ 6.3	+ 6.3

*Emerging Mkts. †JPMorgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Trading market value.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.